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THESIS

A CASE FOR THE OPERATING HOLDING COMPANY IN LIGHT AND POWER

by

SARA CRAIG BODELL

(B. B. A. Boston University, College)
(of Business Administration, 1923)

submitted in partial fulfillment of
the requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION

1939

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INTRODUCTION

This study was actuated by the writer's interest in public utilities, and by the fact that public utility holding companies have been and are the subject of much controversial discussion at the present time.

Much has been written on the subject both politically and academically. The writer is to emphasize in this discussion the operating holding company, in the light and power field.

In discussing this subject it will be necessary to differentiate between types of holding companies, showing how the general and operating holding companies differ.

The writer will attempt to trace the development of the holding company in the light and power field, using some of the larger and more familiar holding companies as examples.

By the use of charts and tables the growth of the industry, and the economies of operation will be shown, reflecting the contributions to society which are directly attributable to holding company operation.

Inasmuch as it is uneconomical to have competitive power lines in the same territory, the light and power business has to be operated as a monopoly, and is therefore subject to regulation. The writer will trace the history of regulation, both State and Federal, including a discussion of direct government competition, using the Tennessee Valley Authority as an illustration.

The discussion will include the "Public Utility Act of 1935." This is a New Deal measure designed to provide permanent jurisdiction by a Federal Commission over all holding companies in the electric light and power field.

In conclusion the writer will try to prove that the operating holding company in the light and power field is economically justified, and that the abuses which are obvious, and readily admitted by leading men in the industry, can be corrected by more effective state regulation.

I. DEFINITION OF TERMS

" The holding company may be defined as a corporation formed primarily to acquire the voting securities of other corporations, and thereby to control their policies and operations. Such a corporation may incidentally own securities other than those with voting power, and it may also own and operate property directly, but these are distinctly secondary activities. To be a pure holding company its holdings must be confined to one industry, or to allied industries supplying raw materials or accessories.

" The holding company should be clearly differentiated from the ordinary corporation; first, that today this form of control over economic activity is by far the most important result of the corporation's dominance in business. Second, the aim of the holding company can be sharply distinguished from the aim of the ordinary corporation. Its aim is to control policy and men, as against the ordinary corporate aim of making or selling a commodity or service. The organizers of holding companies seek a profit from the control they exercise over other profit-making corporations, while the ordinary corporation makes its profit by the performance of some direct economic service. The only activity needed to carry out this control is the acquisition and retention of voting stocks in other corporations." (1)

Expressed a little differently " the holding company may

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(1) "Business Organization and Control". Tippetts-Livermore, Page 211-212.

be defined in terms of its distinguishing characteristic, as any company with share capital which is in a position to control or materially to influence the management of one or more other companies by virtue, in part at least, of its ownership of securities of the latter. A holding company may be classed as a pure holding company if its assets are composed almost entirely of the securities of other companies, and as a parent holding company (or parent company) if in addition to the ownership of such securities it conducts an operating enterprise as a directly owned property." (1)

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. Volume IV. Editor-in-chief Edwin R. A. Seligman, Associate Editor Alvin Johnson. New York, The Macmillan Company, 1937. pp. 403-404

II. DEVELOPMENT OF THE HOLDING COMPANY

A. HISTORY

1. United States

(1) Economic history records the beginning of industry in the homes, where each member of the family was responsible for some simple task of production. As wants increased, capital and managerial skill became necessary, and the partnership system was devised. This step recognized a distinction between capacity for production and the capacity for management. Still greater progress resulted in the creation of the corporation, to be followed by the consolidation of corporations into the present centralized and balanced facilities of production, known as the holding company.

(2) This form of combination, although not unknown prior to the latter part of the 19th century, became an important institution of business enterprise in 1888 when the state of New Jersey first made possible the extensive use of the holding company by amending its general stock corporation law so as to enable all companies formed under it to

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(1) Based on Facts in Handbook of National Electric Light Association. Holding Companies and Centralized Management. pp.67

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include in their charter the specific power to hold stock in other corporations. This provision was clarified and extended in the following year and still further broadened in 1893. Other states were forced by competition for charter business to adopt similar provisions. Between 1892 and 1899 the lead of New Jersey was followed by New York, Connecticut, Pennsylvania, and Delaware. By 1929 thirty-nine states had expressly authorized intercorporate stockholding. Thus in a period of forty years the holding company, which had been regarded as undesirable and contrary to public policy except under unusual conditions, was made by most states an acceptable and legal practice.

2. Europe

(1) While the holding company is considered a characteristically American type of combination, we find isolated cases in Europe as far back as the sixties. However, its real development did not occur until 1886 with the formation of the Nobel Dynamite Trust Company, Ltd. in London. This was made up of English, German and Swiss companies, also companies located in Mexico and Brazil.

The holding company has never assumed the same significance in Europe as in the United States, inasmuch as the railroads and public utilities, a favorite field for its

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(1) Based on Facts, Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. Holding Companies. pp. 410-411

operation in this country, were and still are government owned in many instances.

In Europe the holding companies of the financing type are more popular than those formed for the purpose of monopolistic control. The disproportionate international distribution of wealth during and after the World War furthered the use of the holding company in the international field as a convenient form of control of foreign enterprise.

B. TYPES

1. Pure Holding Company

A pure holding company exists for the purpose of holding securities of other companies. The aim of the organizers is to control policy and men, seeking a profit from the control they exercise over other profit-making corporations. The government feels that this type of holding company in the utility field should be eliminated, inasmuch as it does not serve an economic function.

2. Operating Holding Company

An operating holding company exists for the purpose of providing centralized engineering, financial, new business, operating, accounting, purchasing and other similar

services and supervision at a fair price, or at a cost much below that for which these services could be purchased by the separate operating companies. The government recognizes that holding companies extending this type of service are indispensable to the small electric light plant.

C. REASONS FOR DEVELOPMENT

1. Economic Reasons

(a) Difficulty of Securing Capital

"Half of America lives in towns of ten thousand or less or on farms. Here are fifty million people to whom electric service is as necessary as it is to metropolitan homes and industries.

"But because of the special characteristics of electric service, the early development in such territories was slower than in larger centers of population. A relatively large capital investment is required to furnish electric service, five dollars for each dollar of annual gross income. If the cost of service is to be reasonable and competitive, operations must be efficient, economical and on a relatively large scale. Nor can these standards be realized unless the demands for service are distributed over many hours of the day, so that maximum hourly use will be made of the investment.

"Could the isolated local plant in a small

community succeed under these conditions? It soon became evident that it could not. The small company, unknown to all but local investors, found itself unable to attract new capital with which to expand facilities or meet maturing obligations. Moreover, the small plant, limited in facilities and capital, and frequently operated only from dusk to dawn, could not take on the large power loads which make for generating efficiency. Nor could it go beyond the boundaries of the town to serve the farms, the mines, oil wells and quarries. Electric service, rapidly becoming a most important industrial asset to the larger cities, was threatened with stagnation in the small towns and outlying areas.

"....Public Utility Holding Companies were formed to correct this situation. Their purpose was to meet the financial requirements involved in providing an adequate electric service to small towns and non-metropolitan areas. Based on the diversity of the properties brought under their direction, they established a sound financial structure attractive to the investor. With the necessary capital thus made available, they proceeded to unify small systems and to replace inefficient local plants with economical large plants, adequate in capacity to serve a number of towns and a wide surrounding area. They broadened the service areas of the plants, embracing enough different users to cause more constant use of the facilities. By strengthening the investment they lowered capital charges, which together with reductions in operating costs resulted in lower rates for service. By

standing ready with ample power they released small town industries from a serious restriction to their expansion, and they went out into the surrounding country with power for the exploitation of natural resources and for farms.

"Only through this physical unification of facilities was operating efficiency possible in small towns and rural sections. Only through corporate unification was it possible to establish the financial standing on which to base the necessary flow of invested capital.

"This is the service the Holding Company offers to half of America." (1)

(b) Necessity for Dependable Service

The small isolated plant, operating with obsolete equipment, was unable to supply dependable service for twenty-four hours a day. Through interconnection, electric service today is practically free from interruptions, so that some homes are completely electrified, using lighting, small appliances, range, refrigerator, water heater, oil burner operated by electric motor, and in some cases electric heaters. Except in the case of severe storms the supply of electricity can be depended on for use at any hour of the day or night.

The interconnection with modern generating plants

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(1) Middle West Utilities Company, The Public Utility Investment (or "Holding) Company, Its Functions and Accomplishments. Reprints of a Series of Advertisements. 72 West Adams St. Chicago, Illinois. No. 7, pp. 20-21-22

through holding company management, eliminated the hazard of interruptions for the large power customer. The expense to to the power customer because of failure of the electric power supply is considerable, as his machinery and men are idle and production is curtailed until the power supply is resumed. In these days of efficient management, shorter working hours, and higher wages, a production department must plan on a minimum number of interruptions in a given period.

(c) Comparable Rates in Town and City

A generating station and distribution system operating at a high and continuous rate of output, can produce and distribute power at a much lower cost per unit of service than when operating at a low and widely varying rate of output. Therefore, through interconnection as developed by holding companies, electric current is transmitted from the larger, more efficient plants to the smaller communities, resulting in dependable service at rates that compare favorably with city rates.

For example, the writer in the Spring of 1938 attended a strawberry festival in a little town in Vermont. Warm shortcake was served from the kitchen, and upon investigation it was found that an electric range was being utilized to bake the cakes as needed. Upon inquiry the writer found that cooking was being done on a two cent rate in this little hamlet of not more than a dozen houses. An isolated operating

plant could not exist in this territory, and interconnection had brought all the advantages of electricity to this little farm, which hitherto depended on wood and oil for cooking, heating and lighting.

2. Personal Reasons

(a) Self-interest of Equipment Companies

Following the experimental period from about 1880 to 1892, the General Electric and Westinghouse Companies emerged into the dominant positions in the equipment trade which they still occupy today. From 1895 to 1910 these two large manufacturers were forced to create new markets by assisting in the promotion and organization of light and power companies in all parts of the country. In lieu of cash the General Electric Company took in payment bonds and stock of the companies to which they sold their equipment, and these securities became the nucleus of Electric Bond & Share Company, which General Electric continued to control until 1925.

(b) Self-interest of Engineers and Managers

(1) To extend their share of influence and make permanent their managerial connection with the industry,

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(1) Based on "Business Organization and Control." Tippetts-Livermore.

individual engineers, or firms, naturally looked with favor on the holding company device. By organizing such units they could secure a maximum of security and freedom in their work with a minimum of investment. Nor were they without courage and initiative in so doing; for their share of the invested capital being in the equity securities, bore the full risk of loss should the industry have suffered reverses instead of the prosperity it has enjoyed.

(c) Influence of Promoters and Bankers

Bankers fostered and encouraged the holding companies that were sponsored by equipment concerns or engineer-managers, because they preferred to deal with them, insofar as the holding company meant more stability, more responsibility over a period of time. It was felt that the interests of investors would be served best if the capital were controlled by such responsible groups. Larger issues, wider reputations among investors for such companies, and continuous managerial responsibility meant more active markets for new bonds and stocks, and a corresponding ease in securing the constant new increments of capital which the rapidly growing industry so urgently needed.

In many cases the firms that organized the holding companies were primarily promoters. It was their practice to buy a property as cheaply as possible, then

write up the book value to a level nearer its potential earning power. In the recapitalization these promoters realized handsome profits.

(d) Permanent Aid in Decentralization of Administration

" An important use of the holding company is as a permanent aid in decentralizing the administration of great modern combinations. By maintaining separate branches of an enterprise as separate corporations with separate and semi-independent Boards of Directors, the management of a concern can conduct it more as a group of federated enterprises than as a single armylike organization. Some of the advantages of combination can thus be obtained without the surrender of all the advantages of smaller organizations.... The degree of decentralization varies with different holding companies. While some are unified almost to the extent of obliterating corporate lines, in some cases financial control alone may be centralized, while operations of subsidiaries are conducted as if they were independent. Between these extremes the great flexibility of the holding company allows any degree of centralization desired." (1)

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. op. cit., p.p. 406.

(e) Separate Incorporation of Property in Different Countries or States

" Another use of the holding company which deserves mention is the separate incorporation of properties in different localities in order to simplify the adjustment of corporate activities to the laws of particular countries and states. Property in a particular state is often separately incorporated to simplify the problems of accounting and taxation, to avoid taxation or to take advantage of special laws of that state. The holding company thus intensifies the problems growing out of taxation of an enterprise which owns property in two or more states, and the allocation of its property to particular states. It is also customary for American...corporations to conduct their operations in foreign countries through subsidiaries incorporated in the respective foreign countries." (1)

Thus we find that Associated Gas & Electric Company has incorporated its New England properties into the New England Gas & Electric Association, while Electric Bond & Share organized American & Foreign Power to include those properties that were acquired in foreign countries.

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. op. cit. pp. 406

D. OBJECTIONABLE DEVELOPMENT

1. Means of Avoiding Social Control

"The term social control is used here to mean the forms of regulation and publicity designed to protect the interests of the investing, working and consuming public against exploitation by the persons who dominate a business enterprise. It includes not only government regulation, but also the informal although often more effective control imposed by rules of the stock exchanges and by pressure of investment bankers, banks and private investors. Partly because the holding company is a comparatively new device, partly because it is protected from interference by traditional American interpretation of constitutional law, and partly because it often extends beyond the jurisdiction of any one state it has so far been to a considerable extent, although not completely, exempt from the restrictions to which other business corporations have been subject. In the public utility field it has been much more successful in avoiding regulation through its ability to escape control of service charges, financial practices and accounting publicity to which the operating utilities have been subjected. Moreover, in spite of the publicity of accounts in a measure imposed by the investment world on large companies with a widely distributed stock ownership, the holding company has

often been most successful in concealing its operations." (1)

2. Use of Holding Company to Facilitate Capital Inflation

"Bonds and preferred stock as well as common stock of the top company can be issued against junior securities of subsidiaries held in the treasury, so that the total securities issued and in the hands of the public can often be made very much greater than could be issued directly against the underlying property."

"....This is accomplished by a pyramided series of holding companies. Control of the base operating company is held by a holding company through the ownership of a bare majority of the voting stock. This holding company in turn is controlled by another in similar manner, with the result that the third company is in a position to control the first with only a quarter interest in the stock of the latter. The pyramiding may go even further, each additional company reducing the investment necessary for the control of the underlying company. Where each company in the series has bonds and non-voting preferred stock outstanding, the reduction in the investment necessary for control diminishes even more rapidly, so that a pyramid involving three holding companies will allow, say, a million-dollar investment in a top

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences, op. cit., pp. 405.

holding company to control a billion-dollar operating company. The investment necessary for control may be made even smaller by issuing non-voting company stock or stock with limited voting power." (1)

(2) As an illustration consider American Founders, a concern difficult to define, a kind of hybrid holding-financing-trading-investment trust company. Fifty-seven companies furnish power and light to about 350 or 400 communities. They in turn are directly or indirectly controlled by the Central Gas and Electric Company of Delaware. Because of its size, large credit, ability to employ best engineering brains, it is able to operate these companies more efficiently for the community and the investor than these fifty-seven operating companies could do by themselves, therefore its existence is justified.

The Central Gas and Electric Company is owned by the Central Public Service Corporation, which in turn is owned by the Public Utility Holding Company, which owns just enough stock to exercise controlling influence in the affairs of the Central Public Service Corporation. The Public Utility Holding Company in turn is owned by the American Founders. There is no economic justification for the existence of the Central Public Service Corporation, the Public Utility Holding

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences, op. cit., pp. 405

(2) Based on Flynn, John T. "Pyramiding of Holding Companies." The Annals of the American Academy of Political and Social Science. Power and the Public. January, 1932. pp. 16-17.

Company, or the American Founders, therefore it is the development of this type of holding company which is largely responsible for the controversy which has existed for several years between the government and the leaders in the utility industry.

3. Weakens Position of Minority Interest

The use of the holding company may further weaken the position of a minority interest. "If the majority stock is owned by a holding company, the stockholders' position is further weakened by concentration of control in a single block which acts as a unit, and by the opportunity which the holding company has of trading with the controlled corporation (directly or through subsidiaries) to the disadvantage of minority interests. Transactions between a holding company and its subsidiary or between two subsidiaries of a single holding company do not involve independent parties. The holding company is in the position of dealing with itself, and there is grave danger that the interests of the minority will not be protected." (1)

E. EXTENT OF DOMINATION OF ELECTRICAL FIELD.

During the last two decades the extension of the

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences, op. cit., pp. 405

holding company has been extremely rapid in the light and power field in the United States, and at the present time seventy-five per cent of the industry is controlled by ten great systems. This has been due to the fact that the holding company is a means of controlling large systems with a minimum of investment, and as a means of avoiding state regulatory control.

The desire for acquisition of new properties has been so rapid that utility properties in different parts of the country have been brought within a single system, often with little regard to the possibilities of unified operation.

(1) Due to the fact that electric utilities pay more money to capital than to labor, at the present time the typical utility head is a man with a financial turn of mind, and Wall Street is the psychological headquarters of the industry. The 1932 Census showed that the utility industry employed less than 250,000 workers all-told; maintenance crews, engineers, meter-readers, clerks, stenographers, and its annual payroll was only $325,000,000, even though it pays its skilled labor notably well. In 1937 its sales were $2,200,000,000, not a spectacular amount, and less than building, motor fuels, automotive industry, even less than the sales of the industry that builds the utilities' equipment. In the absorption of capital, however, the industry compares with agriculture and the railroads, and in 1932 the total fixed capital of the

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(1) Based on "Washington and Power." Fortune, XVII (February, 1938) pp.63-128.

operating companies was $14,370,000,000. There was $13,600,000,000 of bonds and stocks issued against this, and in the hands of the public, and the interest on this capital amounted to more than $600,000,000, twice the industry's labor cost.

Wall Street is the official headquarters of more than half the industry, and the utility leaders are concentrated within a few blocks of each other. Mr. George Howard, a lawyer, has an office on Broad Street, near J. P. Morgan & Co., and is President of the United Corp., a super-holding company into which the House of Morgan dumped all its utility holdings in 1929. Mr. Howard takes no direct part in the management of the utility industry, but it is a fact that if he were to exercise control over all the companies in which United holds a substantial minority interest, he would be running half the electric business east of the Mississippi. These include the United Gas Improvement Company, the oldest utility holding company in the United States, which controls scattered operating properties from Connecticut to Arizona, but the mainstays are Philadelphia Electric Company and a sizable interest in Public Service of New Jersey. Also owing allegiance to Mr. Howard are the companies of Floyd L. Carlisle, who heads both Niagara Hudson Power, which monopolizes all the power produced on the American side of Niagara Falls, and Consolidated Edison of New York. Mr. Carlisle, who became the

spokesman for the industry during its trying transition from the Insull-dominated days of the National Electric Light Association to the era of the Edison Electric Institute, has been called the biggest figure in the entire utilities picture.

It is such concentration of power in the hands of one man that has made New Dealers believe in the "power trust", and therefore that they are operating contrary to the Anti-trust laws of the United States.

"Although George Howard used to be on its Board of Directors, an independent....system....is Electric Bond & Share, the biggest operating system of them all, whose affiliates do 14 per cent of all the electric business in the United States, mostly in the small towns.....Bond & Share is run by C. E. Groesbeck, an engineer, and the group is noted for its efficient engineering. The....group consists of four intermediate holding company systems, whose properties cover thirty-three states, and a fifth, American & Foreign Power, which represents an ill-starred attempt to take charge of the electrification of a good deal of the rest of the world." (1)

(2) The business of the North American Corp. is conducted by Harrison Williams, a financier, with offices at 60 Broadway. He controls North American through a series of

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(1) "Washington and Power" Fortune, XVII op. cit. pp. 63-128

(2) Based on "Washington and Power." Fortune, XVII op. cit. pp. 63-128

five or six holding companies, and also has had what he terms "an influence on management" in some $2,800,000,000 worth of utility companies, or about a sixth of the assets of the entire industry. Most of the North American properties are of the big-city type; Washington, St. Louis, Milwaukee, Cleveland, and others. Unlike most of the holding companies the government objects to, North American has no service or construction subsidiaries, never interferes in the local management of its properties, and would be no more than an investment trust if it did not perform a few fiscal functions.

The development of the Associated Gas & Electric Company representing approximately $1,037,000,000 is largely due to the efforts of Howard C. Hopson, "who prior to 1915 was chief of the division of capitalization of the New York Public Service Commission. In 1915 Mr. Hopson established an office at 61 Broadway, New York City, as a consultant to utilities. He had as clients in those early years many manufacturing companies and railroads, as well as utility companies. Among them were Associated Gas and Electric Company and various companies which are now subsidiaries of the Associated Gas and Electric Company. It was not until 1922, when he had already established a large business as a consultant that Mr. Hopson became directly interested in the Associated System.....

".....The Associated System grew from a group of companies serving approximately 44,000 customers in 1922 to

one now serving 1,762,000." (1)

(2) The Associated System has been in the spotlight during all the Federal Government investigations. This system is noted for the number of its intermediate holding companies, and for its many classes of stock, with the voting power concentrated inexpensively in one class.

Cities Service was built by Henry L. Doherty, who is better known for his pioneer work in oil conservation, has properties scattered from Virginia to Wyoming, and although it is not one of the biggest systems, it is famous for the enthusiasm with which its stock has been sold by employees to customers in the Insull fashion.

Other well-known systems are Standard Gas & Electric Company, organized by the construction engineer H. M. Byllesby to sell securities for the operating companies whose plants he built. Utilities Power & Light was put together by Harley L. Clarke of Chicago, and has now been reorganized, and is under the control of Floyd Odlum of Atlas Corporation. Floyd Odlum was connected with Electric Bond & Share during the Mitchell period, and his Atlas Corp. has been closely associated with Mr. Williams in the ownership of North American.

With such concentration of power over the electric industry among a handful of men it is not surprising that the public is demanding that the government take some action to put an end to it.

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(1) Letter mailed Wednesday, Dec. 28, 1938 to security holders. Associated System to Mutualize Hopson Service Organizations.

(2) Based on "Washington and Power." Fortune, XVII pp. 63-128.

III. FUNCTIONS OF THE HOLDING COMPANY

A. PRIMARY FUNCTIONS

1. Business Management

(a) Obtains Required Capital at Favorable Rates

Analyses of security issues of both large and small companies, placed with investors over the last ten years, show that the cost of money to the small independent utility is generally from one per cent to one and a half per cent higher per year than in the case of financing by larger and stronger companies.

Further, because of the small sums involved, it is costly for small companies to raise money. Large issues find a ready market, and the cost of advertising, commissions, legal opinions, etc. spread over a large issue are not a heavy burden.

With the combining of the smaller utility properties through the medium of the holding company under more competent central management these obstacles are largely removed. By combining many plants the investment becomes diversified and the risks inherent in individual companies are spread and diminished to the owner of the holding company securities.

The holding company is generally equipped to handle the capital needs of its subsidiaries and to market their securities through its own organizations. It can often finance the requirements of the associated properties from its own resources, which is especially helpful in periods of financial distress.

The data of Chart Number 1 show the increase in capital invested in the electric light and power industry, from $4,817,000,000 in 1922 to $12,900,000,000 in 1934. The additional investment during the last twelve years was approximately twice as large as the total investment during the preceding forty years. It was chiefly through the efforts of the holding companies that this large amount of capital became available to the industry, and is basically responsible for the growth which the industry was able to make during these years. (Source of data: Electrical World) (1)

(b) Furnishes Centralized Skillful Management

Utilities serving large cities can afford the best management, but the companies operating in small cities are unable to do so. The small company executive performs a variety of duties extending all the way from

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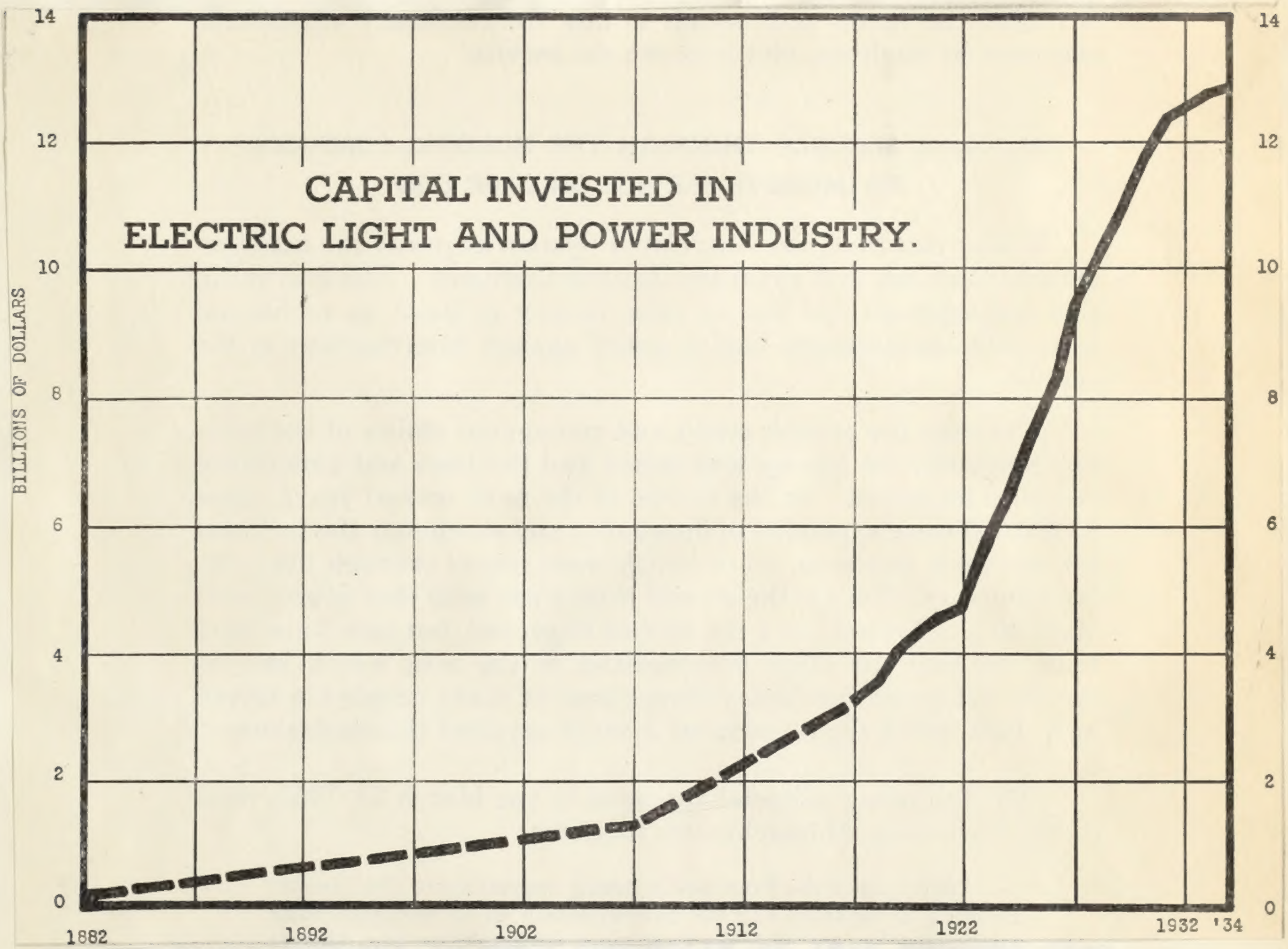
(1) Based on Starch, Daniel. Contributions of Holding Companies Toward Developing the Use of Electricity. Statement filed with the Committee of Interstate Commerce, Senate of U.S. 5/3/35. pp. 3

CHART NUMBER 1



construction and maintenance engineering to the different duties of management. Specialization as developed in large cities is here out of the question, for although at times expert services are necessary, there are not enough of such situations in the small utilities to justify the employment of highly skilled officers. Through holding company not raise the funds [illegible] to buy the necessary equipment, maintain its facilities, and improve the service.

$1,200,000 SECURED THROUGH THE HOLDING COMPANY TO IMPROVE SERVICE ON CAPE COD

About this time, the Associated System acquired the management of the Cape and Vineyard Electric Company. The first thing this management did was to raise money to build an additional [illegible] transmission line to guard against interruptions in the service.

Through the greater credit and managerial ability of the holding company, the money was raised and the lines and generating facilities improved. In the course of the next several years, some $1,200,000 were expended in improving and extending the facilities for service in that area, all of which was secured through the holding company. Today, the service [illegible] with that of any good sized city. Not only was the service improved, but new lines were built out into the other communities in the area which had no service before, so that today three times as many people are served as in 1928 when the Associated System acquired the management.

The following editorial appeared in the March 23, 1935, issue of the Yarmouth, Massachusetts Register:

> "In spite of the President's strong opposition to the Electric Holding Companies and his determination to exterminate them, [illegible]

affiliation, expert management at a minimum of cost per unit of service is available to each operating company regardless of size.

(c) Fixes Responsibility for Management

The holding company is responsible for the efficient operation of all branches of the business it controls. This covers not only the central organization, but this obligation attaches equally to the skill and efficiency of the management of each local group and must be reflected there in operating results, rates, business development, and public relations. Hence, the holding company must train and attract from other fields men of outstanding capacity and aptitude for the specific classes of work the public utility service demands. The results of the intensive studies made by these specialists are made available to even the smallest and most remote unit of the group. Expert skill and efficiency is therefore brought to each community at less expense than is incurred for the type of management usually found in small independent companies.

(d) Standardizes Accounting

Proper accounting systems adapted to the needs of each operating group, and conforming to public service commission requirements are installed in each property. Each

unit uses the same accounting methods, and prepares the same records, so that comparison of operating results between different units is possible, thus making the methods and equipment responsible for the best results available for all. Periodic audits are made by the central organization, as well as comprehensive cost studies which serve as a valuable guide for the management. The centralized accounting organization prepares and supervises the compilation of accounting reports of the different operating units, tax reports and other statements required to be filed with public authorities.

(e) Centralizes Purchasing

Centralized management concentrates in one organization the purchasing and inspection of all construction and operating materials and supplies required for the entire system controlled. By combining and placing as one order the annual requirements of the various subsidiary companies for standardized equipment and supplies such as meters, transformers, poles, towers, wire and other line material, the unit cost is much lower than if purchased by each company separately.

In the purchase of large units of equipment and apparatus of unusual design and type there are substantial economies when purchased by experts. This type of equipment is purchased only at intervals of many years by

the smaller companies, but the holding company purchases sufficient to warrant the maintenance of a staff of experts experienced in the design, construction, and operation of such units. The combined purchases entitle the holding company to a better price and also more prompt deliveries, because the orders it places under its many contracts are enough to keep whole factories in operation.

With centralized purchasing by the utilities, manufacturers are in a position to arrange for purchase of raw material on a basis that produces savings to them, and therefore reflects in the contract prices to the holding companies. When this saving is made available to the operating units, the benefits of centralized purchasing are obvious.

(f) Supervises Advertising and Publicity Work

Centralized management provides advertising experts who know best the proper time to run campaigns, and the method of advertising them. As the future of the electric industry is dependent upon the promotion of merchandise sales, it is to the best interest of the central organization that each supervised company shall introduce to its customers the most efficient appliances and demonstrate the most satisfactory methods for using them, and to make these appliances available on convenient terms.

(g) Provides Comprehensive Insurance

Centralized management provides that the property and business and also the operating staffs of the company shall be properly covered by insurance. Fire, boiler explosions, water damage, workmen's compensation, automobile, and life insurance are all arranged for by experts at a lower cost than could be obtained by each company independently.

2. Industrial Management

(a) Furnishes Centralized Skillful Operating and Construction Service

Centralized management through its control or supervision of construction work leads to a standardization of designs, equipment and methods with greatly increased economies. Service standards and maintenance routines are prescribed and enforced. The combined units produce enough construction and reconstruction work each year to maintain a competent central organization with the result that expert construction and maintenance staffs are always available, the benefits of which are extended to all the operating units both large and small.

An outstanding example of these benefits occurred during the hurricane-tidal-wave storm of September 21, 1938. When the utilities serving the territory effected were unable to obtain experienced linemen, construction and

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(b) Effects a Consolidation and Interconnection of Small Plants

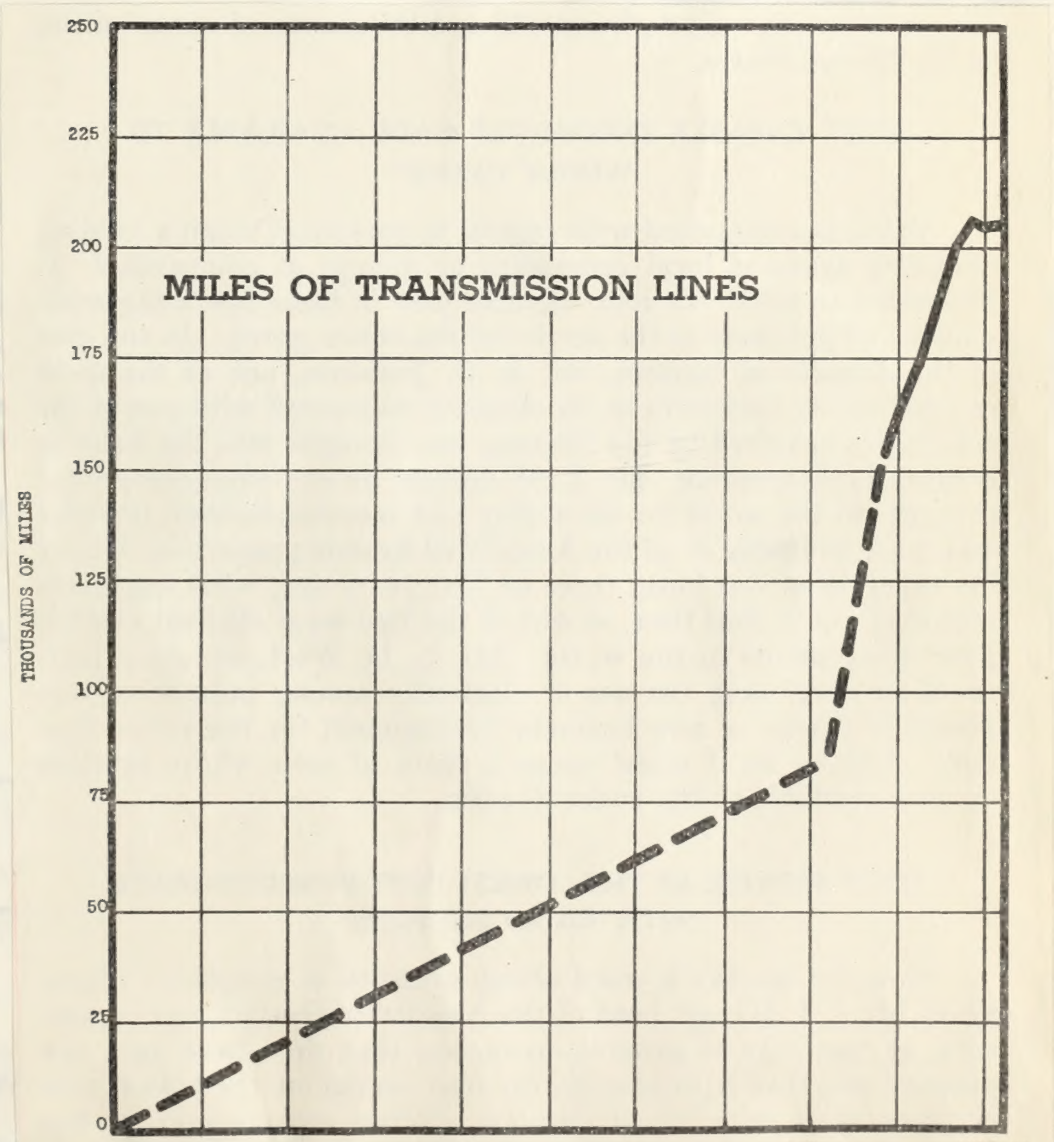
The principle reason for the development of the holding company and centralized management is found in the advantages of large-scale operation. An analyses of operating costs shows that expenses fall into two major classes, namely "fixed expenses" and"variable expenses." The chief "fixed" costs are interest, depreciation, taxes and the cost of management. The amount of these costs in any plant is dependent on the maximum demand which the plant is constructed to meet. If a plant is not used to capacity the unit of expense becomes high if spread over a low output. The "variable" expenses are governed more or less by the use that is made of the facilities. They include expenditures for fuel, some maintenance and a portion of the labor cost, and vary in accordance with volume of output.

The holding company, therefore, through interconnection and consolidation is able to bring about much greater use of facilities, giving a much wider base over which to spread the "fixed" and"variable" costs. If a plant is proven to be inefficient it may be abandoned and transmission lines are built to serve the communities from large modern

stations constructed at strategic locations.

(1) In 1923 or thereabouts when the holding companies got under way, there was 86,290 miles of transmission lines. In ten years, or in 1933 this mileage had increased to 208,097 miles. The data of Chart No. II show the growth from 1923 to 1933 only, as figures are not available for the prior period when there were mostly independent scattered plants.

CHART NUMBER II



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(1) Based on Starch, Daniel. Contributions of Holding Companies Toward Developing the Use of Electricity.op. cit., pp. 5.(Source of data: Edison Electric Institute and Electrical World.)

"The benefits to a community from being served by a unit of a group of properties that in turn constitutes part of a large holding company system, are apparent from Table No. I which follows.

TABLE NUMBER I

ECONOMIES RESULTING FROM CENTRALIZED CONTROL AND MANAGEMENT

	Consolidated System	Small Intermediate System	Theoretical isolated property
Number Communities Served Retail	174	5	1
Population Served Retail........	621 180	18 966	3 600
Average Population Per Community	3 570	3 795	3 600
No. of Main Generating Stations.	5	1	1
KW Capacity of Generating "	143 500	3 940	400
KW Maximum Demand	140 300	2 360	200
Annual Load Factor...............	49.7%	33.0%	25.0%
Annual Plant Use Factor.........	48.6%	19.7%	12.5%
Miles of Transmission Line......	2 384	27	0
Cost of Energy Delivered to Distribution System-			
Operating Costs per KW:			
Generation................	0.404¢	1.260¢	2.410¢
Transmission & Substation	.075¢	.019¢	.000¢
Total......................	.479¢	1.279¢	2.410¢
Fixed Costs per kwh (1).......	.623¢	1.550¢	2.480¢
Total Cost of Distribution System..	1.02¢	2.829¢	4.890¢

(1) Based on Investment in plant, transmission line and substation only.

"The table shows in the first column the cost of energy delivered from central generating facilities of a holding company group serving 174 communities with a combined population of 621,180 and an average population of 3,570. The second column

shows the corresponding cost of energy produced locally from a single and independent plant serving a city of nearly 18,000 population, and four nearby villages. The third column shows the cost of producing electricity in a typical small city with a local, independently-operated plant. The population of this community is approximately the same as the average community served by the consolidated system. To avoid unfair comparisons, the data for all three columns have been adjusted to the same quality of fuel and the same cost thereof per Btu delivered at the several plants.

"It will be seen that the combined power needs of these 174 communities, spread over half of the state in which they are located, are served from five modern high-efficiency stations constructed at strategic points and operated under centralized management, thus bringing to each community the benefits resulting from holding company control. Each of these five stations, with an average capacity of approximately 29,000 kilowatts, is over seven times as large as the independent plant serving the medium sized city and referred to in the second column, and almost seventy-five times as large as the plant serving the isolated small city. Because of the diversity of the demands in the holding company group the installed capacity for that system needs to be little more than the maximum demand it is called upon to meet. The plant capacity that serves the intermediate community is over 60 per cent greater than the maximum demand that it meets, while in the isolated city the installed capacity is double the maximum demand. This latter

duplication of equipment is necessary in a small plant because of the danger of a breakdown in the single machine that ordinarily carries the plant load.

"Interconnections and operating economies brought about through consolidation resulted in an annual load factor for the combined system of nearly 50 per cent, as compared with only 33 per cent for the intermediate community and 25 per cent for the small independent plant. The variation in the annual plant use factor is even greater and is equally to the advantage of the holding company system.

"When production costs, including transmission costs in the first two instances, are reduced to terms of cost per unit of service, the operating cost for the consolidated system is .479 cents per kilowatthour as compared with 1.279 cents for the intermediate system and 2.41 cents for the isolated small community. Fixed costs per kilowatthour also show a wide variation in the three instances compared. Because of the greater output in the holding company system, which the higher load factor makes possible, the communities in this group enjoy the advantage of a greatly increased number of units of service over which the fixed expenses can be distributed. Hence, the fixed costs per kilowatthour delivered locally in the large consolidated system are only .623 cents, as compared with 1.55 cents in the intermediate sized plant and 2.48 cents in the small independent community. The total cost per kilowatthour delivered to the distribution system in the consolidated group is 1.102 cents per kilowatthour, as compared with 2.829 in the intermediate sized plant, and

4.89 cents in the typical small plant. The comparable cost under the holding company system is less than half the cost for the medium sized intermediate plant and less than one-fourth the cost for the small independent plant.

"These economies explain the extraordinary growth of the electric utility industry that has taken place in the smaller cities, villages, hamlets, and even in the agricultural districts since the advent of the holding company movement. Such expansion would have been impossible except for the holding company system as is evident from the costs shown in the second and more particularly third columns in Table No. I. The reason for the holding company is therefore purely economic, and it will probably continue to grow until some other method can be devised that will accomplish the same results more expeditiously or make possible still lower rates to the public." (1)

(c) Establishes Scientific Basis of Rate Making

From the early period of paying "so much per lamp per year" there has developed various types of rates, each intended to obtain from customers enough revenue to meet all operating expenses, allowance for depreciation, taxes, etc., also a net return on the "fair value" of the property.

(2) With the invention of the meter, electric utility service was placed upon a commodity basis, and residential customers paid for their electricity on a kilowatthour basis. The kilowatthour is a unit of energy, and the

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(1) National Electric Light Association Handbook. op. cit., pp.64-65.
(2) Based on Guy, David J. Residential Rates for Light and Power. Natural Resources Production Dept. Chamber of Commerce of the United States, Washington, D.C., July, 1934. pp. 7-8-9-10-11.

kilowatthour rate, which is a part of every rate form, is called the "Energy Charge." The commodity basis of charging for residential electric service served well to measure the quantity of a customer's use, but it offered no solution to another difficulty in rate-making known as "availability" of the commodity. In the electrical industry the commodity, that is, the kilowatthour of energy, must be manufactured the instant it is taken by the customer, and it must be used by the customer the instant it is taken. Therefore, an electric utility must have capital invested in a plant of sufficient size to respond instantly to the largest simultaneous demand of all its customers. The customer's rates must cover the expense of the plant necessary to carry this peak load. In an effort to distribute such costs more equitably among its customers, the electric utilities have devised what is known as "demand charges." For example, assume that an assembly hall is lighted by one hundred 60-watt lamps. To light the hall for one second consumes an insignificant quantity of current, in fact only 1/600 of a kilowatthour. But to take care of this limited demand for service, there must be over 6,000 watts of generating equipment available at the power house ready to answer such a call for light, the same as if the use were continuous. Ordinarily this hall would be used only a few hours each week. This shows why energy consumption is limited, or varies widely, as it often does with different classes of customers, the demand charge serves better to distribute the investment cost in the light and power business. Numerous rate forms have been worked out to make this adjustment in charging customers. These fall into four

classes, as shown by Table No. 2.

TABLE NUMBER II

ELECTRIC LIGHT RATES

(a) A straight demand rate as with industrial customers.
Example: Available for water-heating-
$2.00 for 600 watt heater
2.50 " 750 " "
3.00 " 1000 " "
4.50 " 1500 " "

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(b) A demand charge based on the number of rooms in a customer's house.
Example: Available for cooking, water-heating, and lighting.
Demand Charge-
$2.05 for first 4 rooms
10¢ extra for each additional room.
Energy Charge-
3¢ per kilowatthour.

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(c) A demand charge based upon the square foot floor space in the customer's premises.
Example: Available for lighting and other uses in residential premises.
8.5¢ per kilowatthour for first 2 kilowatthours per 100 square feet of floor space
5.0¢ next 70 kilowatthours (all floor space taken together.)
3.0¢ excess.

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(d) Diminishing or "quick-breaking" rate for different "Blocks" of energy used, numerour forms in use.
Example: In residential service installation.
6.5¢ per kilowatthour first 25 kilowatthours
5.0¢ " " " next 35 "
3.0¢ " " " " 140 "
1.5¢ " " " excess.
Minimum bill $1.00 per month.

Method (a) is rarely used for residential service, except where cooking or water-heating is involved. The other three methods are in general use with variations and combinations. The possible drain on a power company's power supply system which a residential customer may make is, roughly, proportionate to the size of his residence, as expressed in the number of rooms (b) or in floor area (c). Method (d) is growing in favor because of its simplicity. The demand feature in this case is covered in the comparatively high energy rate for a small amount of energy used. This small amount, called "block" of energy, is first deducted from each customer's total use for the month, after which lower rates apply. "Quick breaking" implies that the rates fall quickly from the initial or top rate, after which successive reductions affect larger and larger blocks of energy.

The "customer charge" is still another factor frequently found in domestic rates. It is intended to cover those costs which are common to all customers regardless of either the amount of energy taken, or the demand the customer makes upon the system for service. It includes such tangible cost items as meter reading, meter repairing, billing, bookkeeping, collecting and other expenses.

It requires skilled engineers to determine rates that will be satisfactory to the consumer and the company, and at the same time meet with the approval of the state regulatory bodies. Centralized management can provide even the smallest unit with the services of experts in rate-making.

B. DETRIMENTAL FUNCTIONS

1. Management Contracts

(1) There are abuses and dangers present as the maze of intercorporate relationships and contracts which grows up within the typical holding company structure is not clarified or checked by the forces that operate in competitive industry. Nor is there adequate publicity or discussion among stockholders of managerial contracts, the only knowledge obtained through rate regulation cases before commissions or courts or from hearings before Federal Trade Commissions.

2. Favoritism in Granting Security Sales

(2) There has been numerous cases of favoritism and abuse of power, one of the worst being the granting of security sales to investment firms in which heads of the holding companies have had personal interests.

C. CENTRALIZED FUNCTIONS VARY IN DEGREE

"Some holding companies, whose subsidiaries are small operating units, have found it economical to handle billing and accounting and in fact almost every business activity of their subsidiaries. This would appear quite justifiable

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(1) Based on; "Business Organization and Control." Tippetts-Livermore.

(2) Based on: "Business Organization and Control." Tippetts-Livermore.

where operating properties were small. In other cases, where the operating properties were large and where they are apparently able to carry on most of their routine business transactions themselves, it was found that the holding company could most economically perform certain financial functions such as providing increased equity capital. In general the trend has been for the operating unit to do more and more for itself as it grew in size. It has been noted that holding companies whose subsidiaries were small tended to perform a great variety of functions while holding companies whose subsidiaries were large restricted the variety of their services, rendering primarily the financial, public relations, and legal services." (1)

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(1) Dorau, Herbert B. Some Economic Considerations Bearing on the Place and Significance of the Holding Company in the Organization and Functioning of the Public Utility Industries. Submitted to the Committee on Interstate Commerce of the United States Senate. May 1, 1935. pp. 9-10.

IV. CONTRIBUTIONS TO SOCIETY

A. ECONOMIC FACTORS

1. Domestic or Residential Service

During the early years of utility development street lighting was the first service supplied, and the electric companies were financed locally, more or less as a civic project. As street lights were needed only at night, the plants were operated only during the hours of darkness. "Ironing day" was established, and this household task was confined to a definite day and stated hours, much to the dissatisfaction of both the consumer and the company.

By providing capital for improved plant or interconnection with an efficient plant the holding company not only brought dependable service to localities served by obsolete equipment, but made service available in areas that never had service before. There had been no service available in many of the small towns of 3,000 population or under, as it was seldom feasible to operate an isolated electric property.

"Today in the United States electricity is used in more homes than is any other utility service. Out of a total of approximately 30,000,000 homes, 20,000,000 have electric service, 14,000,000 have gas service, and 13,000,000 have telephone service." (1)

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(1) Guy, David J. Residential Rates for Light and Power. op. cit., pp. 7.

"The domestic use of electricity by residential customers in the United States as a whole increased far more rapidly after the middle of the last decade than it did before. Before 1925 residential use increased 11 kwhrs. a year; after 1925 under the stimulus of holding company management it increased 26 kwhrs. a year. If 1913 is taken as 100, domestic use increased to 150 by 1925 and 239 by 1934, a rate more than twice as fast after 1925 as prior to that date. The data of Chart No. III show an increasingly upward trend in residential use." (1)

"Every community in the United States of over 1,000 population now has electric service; in addition there are over 33,000 villages of less than 1,000 population enjoying electric service and over 20,000 of these hamlets have less than 250 inhabitants." (2)

Without dependable service it would have been impossible for electric appliances to have reached the saturation point that they enjoy today. As recent as 1923 "service on Cape Cod was so poor that customers never could be sure of lights or sure of proper voltage to operate toasters or flat irons. Whenever complaints from customers became too numerous....the management....would move a transformer into that area to quiet complaints in that section. The management simply could not raise funds with which to buy the necessary equipment, maintain its facilities, and improve the service.

"About this time a holding company acquired the

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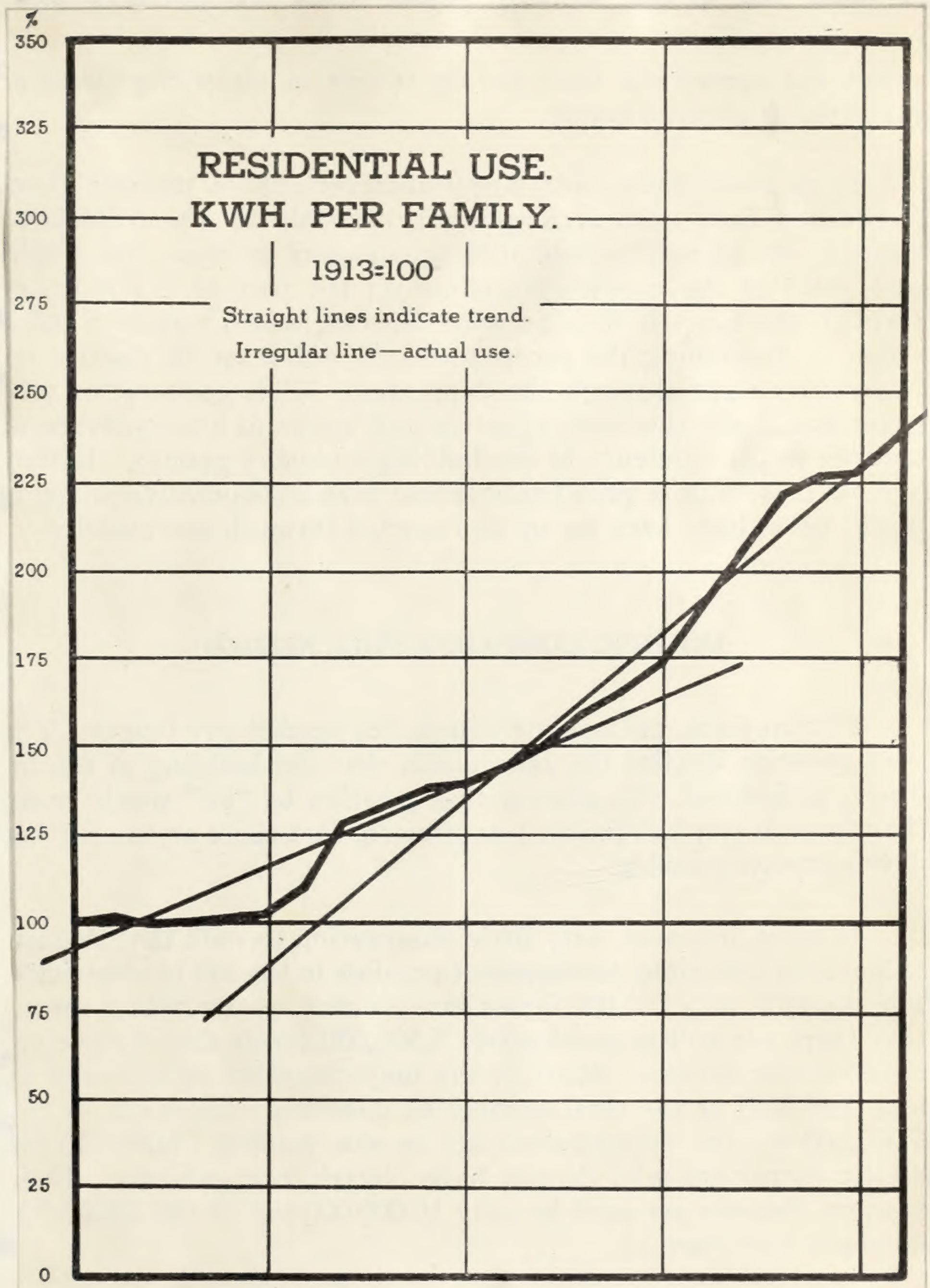
(1)Starch, Daniel. Contributions of Holding Companies Toward Developing the Use of Electricity. op. cit., pp. 9.

(2)Willkie, Wendell L. " 'Lessons' of the T. V. A." The Financial World (June 3, 1936) Reprinted by Edison Electric Institute, 1936. Pamphlet pp. 1.

CHART NUMBER III



management of the Cape & Vineyard Electric Company. The first thing this management did was to raise money to build an additional forty-mile transmission line to guard against interruptions in service....In the course of the next several years, which has spread the labor-saving service of electricity twice as rapidly as it occured before;

Since then, similar and larger achievements in the sale of refrigerators have been accomplished not only by the Associated System, but by many other holding company groups. We might also point to the cooperative effort on the part of the industry through the Electric Refrigeration Bureau, which was very influential in developing the acceptance and wider use of electric refrigerators right through the depression. This cooperative program was made the more effective and easier of accomplishment because of the existence of the holding company groups. If they had not existed, it is quite possible that such a cooperative program would never have been set up and carried through successfully.

HOLDING COMPANIES STILL NEEDED

You may ask, are holding companies needed any longer? The very question implies the assumption that the building of the industry is finished. To answer that question by "no" would mean that the industry has finished its growth, that there are no further developments possible.

It takes, however, very little observation to note that there is still almost unlimited development possible in the use of electricity. For example, only [illegible],000 farms have electric service, which means that there are still approximately [illegible],500,000 farms that do not yet have electric service. Most of the major appliances are used by less than half of the total number of domestic customers. Only 6,000,000 electric refrigerators are in use, leaving 14,000,000 domestic customers who do not have electric refrigerators. Even vacuum cleaners are used by only 10,000,000 out of the 20,000,000 domestic customers.

The average family uses only about [illegible] kilowatt-hours a year. Not some $3,300,000 were expended in improving and extending facilities for service in this area, all of which was secured through the holding company. Today, the service is on a par with any good sized city. Not only was the service improved, but new lines were built out into the other communities in the area which had no service before, so that today three times as many people are served as in 1923, when the holding company took the management.

"The following editorial appeared in the March 23, 1935 issue of the Yarmouth, Massachusetts Register:

> "Apropos of the President's strong opposition to the Electric Holding Companies and his determination to exterminate them by legislation, we of Cape Cod must acknowledge our debt to them for benefits received. Our electric service some years ago was poor. A storm would usually mean the stopping of machinery, loss of light and power for pumping water. It was the entrance in the field of the......a holding company backed by more capital than could be raised locally, that has given us the present excellent service." (1)

Under holding company management the introduction of "promotional rates" made it possible for a family in ordinary circumstances to enjoy the use of labor-saving appliances. These rates are so designed that the increasing use of heavy current-consuming appliances in the home, such as refrigerators, cooking ranges, and water heaters may be at rates which will meet competing services on a comparable basis.

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(1) Starch, Daniel. Contributions of Holding Companies Toward Developing the Use of Electricity, Statement filed with the Committee on Interstate Commerce, Senate of the United States, Washington, D. C. May 3, 1935. pp. 2-4.

These "promotional rates" have been pretty generally accepted by most operating companies with mutual benefit to the consumer and the company.

"A good definition of "promotional rates" taken from an order of the Alabama Public Service Commission, Non-Docket 466, September 12, 1928, is as follows:

> "A promotional rate for utility service has been defined as a rate which successfully develops an increasing volume of profitable business. This end is attained when each customer is offered an opportunity to use additional service at a low follow-on rate for energy consumption."

"Mr. Samuel Ferguson, President of the Hartford (Conn.) Electric Light Company, defines promotional rates as follows:

> "I class any rate as promotional which retains the revenue now received for present usage, but at the same time offers a lower price to each and every customer for the hoped-for but as yet non-existent new business." (1)

The data of Chart Number IV indicate the trend of electric rates from 1913 to 1934. It will be noted that the decline was considerably more rapid after 1925 than prior to 1925, due to the introduction of the "promotional rates." (2)

"The period since 1922 is the most vital to an

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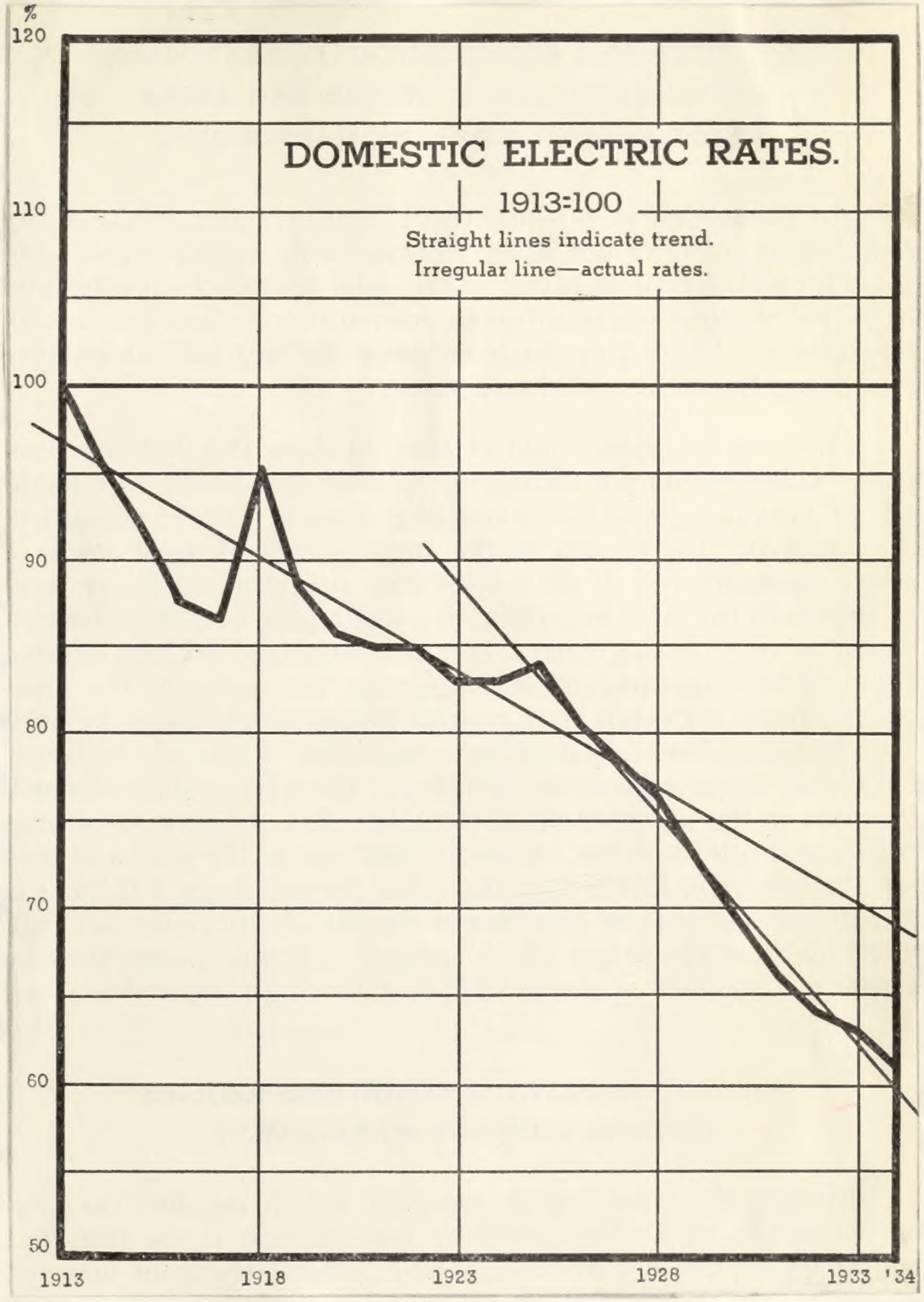
(1) Guy, David J., op, cit. pp. 11-12.

(2) Starch, Daniel. Contributions of Holding Companies Toward Developing Use of Electricity (Source of Data: Edison Electric Institute) op. cit., pp. 11

CHART NUMBER IV



understanding of the domestic rate and use situation as it exists today. The challenge to the electrical industry is that "home electrification" depends upon immediate and

INVENTIVE AND EXPERIMENTAL RESULTS MADE AVAILABLE TO LARGE GROUPS AND AREAS UNDER HOLDING COMPANY MANAGEMENT

Another aspect of this problem is that invention in the utility and electric industry has not yet ceased and, we expect, will not cease for a long time to come. Every new appliance invented and perfected requires special effort to promote its use and gain acceptance for it. So long as that continues, the very skill and ability of holding companies will be required.

Concrete examples could be cited to show that holding company managements are testing out uses of appliances, new methods of promoting and merchandising them in limited areas, and then applying the results to the entire group of areas under a given management. If each individual operating company were to engage in the same experimenting and trying out, the total cost would be very much greater. Not only are large savings effected through holding company management, but many of the ideas which ultimately result in successful selling would never be initiated by the individual operating companies. Some of the larger individual operating companies here and there have achieved much progress in the use of their services, but those happen to be ones which, as a rule, have had an exceptional man at the head and they are the exception rather than the rule. By and large, I think it is safe to say that greater progress in the use of electricity has been made by those companies which are part of larger groups than by separate companies of comparable size, serving comparable areas.

HIGHLY COMPETITIVE CONDITIONS REQUIRE HOLDING COMPANY MANAGEMENT

Finally, the most urgent condition which requires the continued service of holding company management is the fact that beginning with a few years ago and particularly from now on, drastic reductions in rates. The industry's answer is a two-part answer: first, that rates have been reduced as rapidly as prudent management and knowledge of load characteristics and costs permit; second, that the cost of appliances and competition from other fields are the chief deterrents to a wider use of electric appliances in the home.

"Aside from the relative merits of these different contantions the record of the past twenty years shows certain consumption and rate facts of interest to the residential customer. Back in 1913 the average annual consumption of energy by the residential customer was 264 kilowatt hours for which he paid an average rate of 8.7 cents. This was in a period when interest centered in electric lighting . . . very few electric appliances had been perfected and put into use. By 1933 this average residential customer was using energy at the rate of 600 kilowatt hours per annum and paying 5.5 cents per kilowatt hour. Fully 60 per cent of his 1933 energy consumption resulted from the use of large household appliances. The remaining 40 per cent, or say 235 kilowatt hours, may be credited to the use of small appliances and for lighting purposes." (1)

The data of Table Number III show that "the increase in consumption did not develop until about 1920, and it did not accelerate sharply until 1926, when a combination of circumstances, including promotional rate schedules, improvement in design and performance of appliances, and

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(1) Guy, David J., op. cit., pp. 25.

aggressive appliance sale campaigns stimulated home use of electric service. Progress has been continuous since that year." (1)

TABLE NUMBER III

DOMESTIC ELECTRIC SERVICE - 1913-1933

Year	Gross Average Use Kwhrs.	Excess Use Over Lighting Kwhrs.	Average Price per Kwhr.	Average Annual Bill
1913..........	264	14	8.70¢	$22.97
1915..........	260	10	8.00	20.80
1917..........	268	18	7.52	20.15
1918..........	272	22	8.27	22.50
1920..........	339	89	7.45	25.25
1922..........	359	109	7.38	26.50
1924..........	378	128	7.20	27.25
1926..........	427	177	7.00	29.89
1928..........	463	213	6.63	30.70 (2)
1930..........	548	298	6.03	33.04
1932..........	601	351	5.58	33.54
1933..........	604	354	5.49	33.16

The holding company managements have been most successful in planning organized campaigns to popularize the use of heavy-duty appliances such as refrigerators and electric stoves. It is of interest to note that the current now used by the large appliances is nearly double that used for lighting and small appliances. The growth has been rapid since 1926, and the increase in use as shown by the data in Chart Number V. is due in a large measure to the adoption of "promotional rates".

The scientific rate studies which developed the "promotional rates", together with the intensive campaigns to

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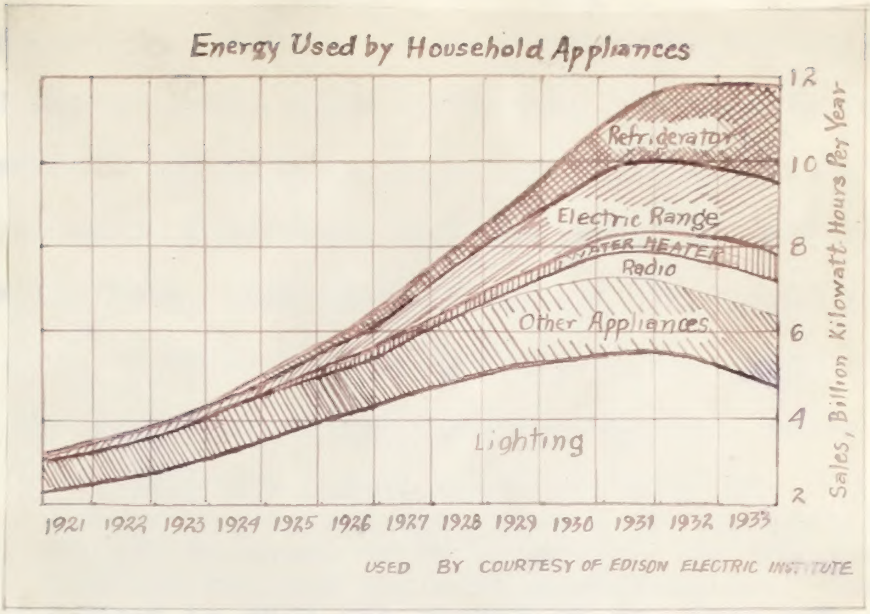
(1) Guy, David J., op. cit., pp. 25-26.

(2) Guy, David J., op. cit., pp. 25-26

CHART NUMBER V



USED BY COURTESY OF EDISON ELECTRIC INSTITUTE

encourage the use of electric appliances, making it possible for a customer to pay a small amount monthly with the light bill, has revolutionized the work of the house-keeper. No longer is it necessary for her to work from sun-up to sun-down to keep the family happy. It is now possible for her to devote time to outside activities, thus lifting the work of the house-keeper out of the drudgery class.

With the assistance of electric power her dinner may be cooking in an electric range with time-clock control, while she calls upon a friend, or does a little gardening; or her washing may be going on while she cleans the house with an electric vacuum cleaner, thus shortening the time formerly necessary for these tasks, as well as eliminating a tired back. Electric refrigeration makes it possible for her to buy in large quantities, thereby realizing a saving in money, as well as in time, and the food remains edible for longer periods, when kept at an even temperature, thus

contributing to the welfare of the whole family. The electrically operated oil burner not only saves the man-of-the-house hours of disagreeable labor each year, but adds to the comfort of all members of the household. Percolators, toasters, radios, clocks, ironers, flatirons, and also water heaters are all servants in the home, made possible by low electric service rates.

"Owen D. Young, chairman of the board of directors of the General Electric Company, has well said:

> Only one danger confronts us. The future electrical development of the United States is bound to be enormous. No one can prevent it, and all must profit by it. The danger is that the growth of the industry will outrun public understanding; that people will see and fear our size without understanding our service. We must make it clear to all that progress consists in lifting the burden of routine and drudgery from their shoulders to the tireless shoulders of the dynamo; that every loafing stream is loafing at the public's expense; that every added kilowatt means less work for some one, more freedom, a richer chance for life." (1)

It would seem that holding company development of the electric service to its present status in the home, contributes no small part toward establishing for the United States the highest standard of living in the world.

2. Industrial Benefits

"In the past, manufacturing plants, save in a few cases in which closeness to raw material was the controlling

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(1) Lagerquist, Walter E. Public Utility Finance. Chicago and New York, A. W. Shaw Company. pp. 48.

factor, have generally located in cities in order to secure convenient, reliable central station power. If they located outside of cities they had to have their own power plants, which was so often uneconomical; and there was the added disadvantage, amounting often to a calamity, of having to shut down a whole industry in case of trouble. With the creation of the interconnected hydro-power lines running primarily from the hydro-generating plants in the mountains to the cities, loads could be tapped en route for industries located outside the cities. This offered industry the advantage of cheap power anywhere and the interconnection of transmission lines insured against interruption of service.

"Thus the problem of power supply in rural and suburban territory has been solved, and many industries have taken advantage of the opportunity presented to them. All of the major California companies are building up new and increasing industrial loads in sections lying beyond the crowded areas in the cities.

"These outside industries secure ample space for their manufacturing operations at lowered costs, and with provision for future expansion at little expense. Natural light and ventilation may be provided, and buildings less expensively constructed, so that real advantages may be secured that will make for economy of manufacturing.

"Then most of all, there is the improved social condition of the employes. Instead of being forced to live in

tenements, or close-packed apartment houses, the common penalty of residing in the larger cities, employes of the factory located in the rural section usually have separate homes where gardens, fruit trees, poultry and flowers contribute to higher standards and greater enjoyment of living. Not only is this a great boon to the worker and his family, but it is an economic advantage of prime importance to the employer, for it means the greater efficiency and larger output that naturally follows improved health and greater contentment of employes." (1)

Progress in the use of electric service in this country has been far more rapid through holding company efforts than it would otherwise have been. It is the opinion of every open-minded person familiar with the history of the industry.

Professor Philip Cabot of Harvard University comments on this fact as follows:

> "In this field the holding companies have been so serviceable that it would hardly be an exaggeration to say that without the use of this method of integration the progress of this industry, outside the great centers of population,would have been delayed for a generation.
>
> "The losses from such delay would have been immense. Electric power is one of the greatest labor-saving discoveries of all time; and to have delayed the spread of it over the more thinly settled parts of the country, even for a few years, would have caused a loss of billions." (2)

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(1) Interconnection - Its Contribution to Better Service and Lower Rates. Nat'l Electric Light Association Employee Information Program. pp. 20-21

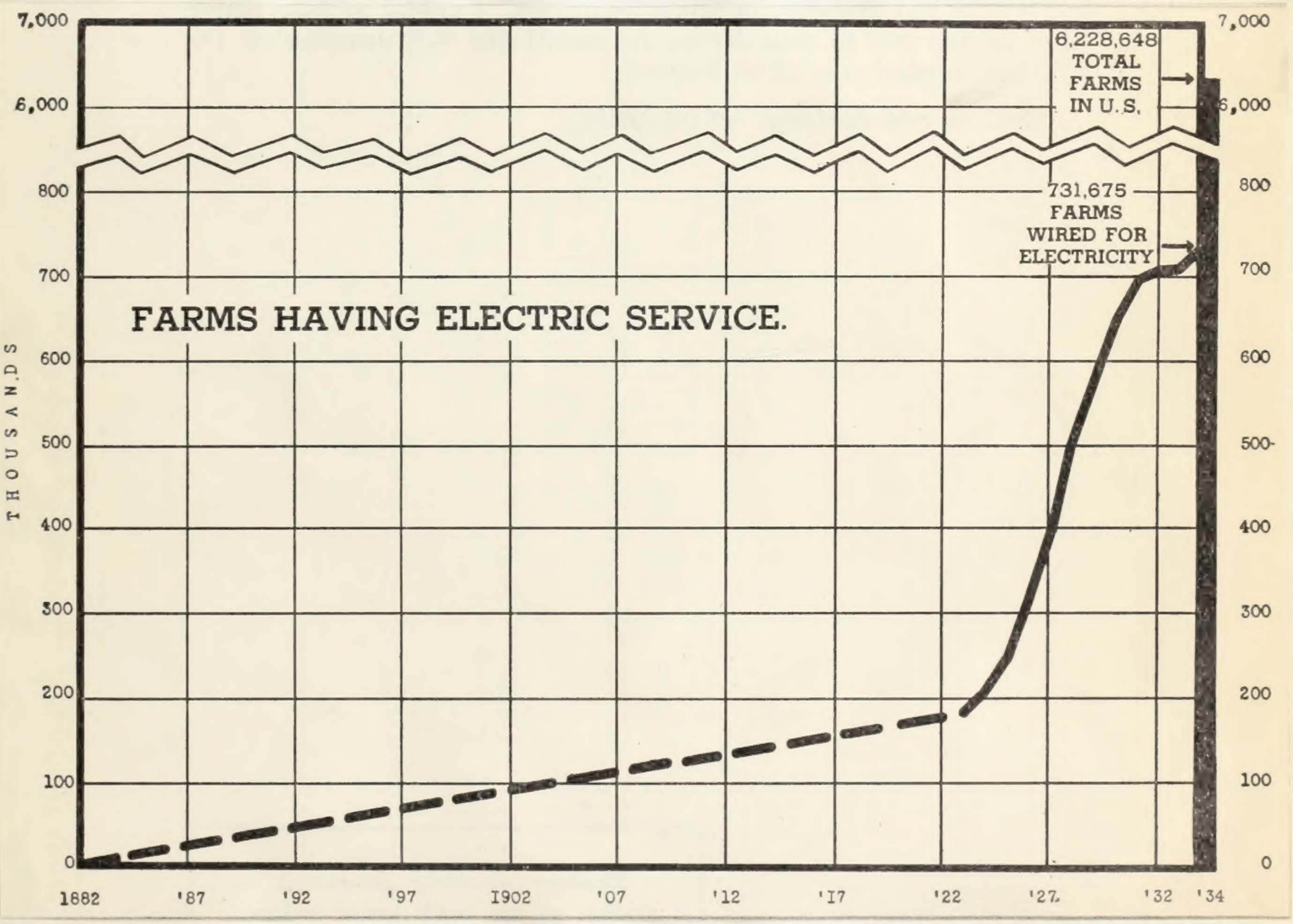
(2) Starch, Daniel. (Source: World's Work, May 1932) op. cit. pp. 8.

3. Benefits to Farms

The number of farms wired for electricity has not increased in proportion to other classes of customers as shown by the following chart. Of 6,228,648 farms in the United States in 1934 only 731,675 were wired for electricity.

The data of Chart Number VI are furnished by the Edison Electric Institute:

CHART NUMBER VI



"The limited income of many farmers prevents home electrification. Take for example the average farmer's income. In 1931 his net return, after paying production cost, interest, rent and taxes, had fallen to $342.00. The following statement was made in the "Year Book of Agriculture, 1933."

> "For the farm families, a large share of the reduction in living expenses must come from many small economies in the various items in the family budget other than food and clothing. This group of expenses includes the cost of fuel, light and other household operations, furnishings and equipment....
>
> "Some farm families are making a considerable share of these savings in the household operation group. Even in more normal times many households depend for their fuel very largely on farm-produced wood and cobs and very little on purchased fuel.....
>
> "Another direction on which many farm families are economizing is in expenditures... for telephones.
>
> "Utility services, whether they be telephone, light, heat, or other conveniences, represent regular monthly outlays, for which the nature of the farmer's income is often not well suited." (1)

The Federal Government, through the Rural Electrification Authority is attempting to extend electric power to rural districts, as they feel that the privately owned companies have failed to develop this phase of the business. They are organized to promote the use of electricity, and advance money to rural electric cooperative associations.

Tennessee Valley Association has organized the EHFA electric appliance sales organization "to advance the

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(1) Guy, David J. op. cit., pp. 12-13.

general economic welfare of the nation. To manufacture, buy, sell, deal in, and to engage in conduct and carry on the business of manufacturing, buying, selling and dealing in electrical appliances and equipment and in goods, wares, and merchandise of every class and description. To lend or advance money to, extend financial assistance to, accept bills of exchange from, endorse the notes and guarantee the obligations of, individuals, firms, corporations, and/or others, without collateral security of any kind whatever." (1)

Therefore, the Federal Government is not only extending lines to the farmers, but it is making it possible for them to modernize their homes through the use of government-financed appliances.

The utility industry has been aware of the fact that the potential market among farmers should have their attention.

"Fourteen years ago the electrical industry commenced the study of rural electrification. The problems presented were numerous and many technical. In cooperation with the Department of Agriculture, state agricultural colleges, farm associations, experimental stations were inaugurated and conducted over a period of years, perhaps the most successful one being the Red Wing Project in Minnesota. That the study has been helpful to the farmer is best attested by the increase in rural customers from the inauguration of the service to date.

The data of Table Number IV show this to be the case. (1)

TABLE NUMBER IV

FARM ELECTRIFICATION

(Figures on Electric Farms Do not Include Those With Individual Lighting Plants)

December 31 of year	Total No. of Farms	Farms Using Electricity Number	% Total
1923		177,561	2.8
1924		204,780	3.2
1925	6,371,640	246,150	3.9
1926		309,125	4.9
1927		393,221	6.2
1928		506,242	8.0
1929		576,168	9.2
1930	6,288,648	649,919	10.4
1931		698,786	11.1
1932		709,449	11.3 (2)
1933		713,558	11.4
1934		743,954	11.8

4. Benefits to the Investor

The holding company, by earning the confidence of the investor, has been able to put his savings to constructive use, and thus assures that ready flow of capital necessary to the ample, economical and expanding electric service upon which the new industrial and social life of the nation is builded.

The fact that the earnings of the utility industry are relatively more stable than those of other industries makes it easy for the better managed holding companies to place

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(1) Weadock, Bernard F. Findings of the Federal Trade Commission and Statement to the Committee on Interstate Commerce of the United States Senate. Address before the Second Annual Session of the Third Annual Convention of the Edison Electric Institute, Atlantic City, N.J. June 3, 1935. Reprinted in pamphlet by Edison Electric Institute, pp. 16.

(2) Ibid. pp. 16

bonds and preferred stocks with conservative investors.

V. REGULATION - STATE AND FEDERAL.

A. LACK OF REGULATION IN EARLY DAYS.

1. Political Theories.

(1) When the electric utilities came into existence in about 1880, the United States had fought two wars with Great Britain to establish and maintain its political independence, and to translate that independence into the development of a new continent. Our ancestors left the older countries of Europe because they wanted freedom, and they wished to establish a government on the North American continent which would provide a maximum of religious, political and economic freedom. The Jeffersonian philosophy, that that government was the best that governed the least was firmly fixed in the minds of men.

2. Failure to Recognize Electric Utility as Natural Monopoly.

Shortly before the Civil War the New Jersey Supreme Court held that a gas company in Paterson was not obligated to sell gas to a prospective customer even though his premises were located on a street which the company had piped

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(1) Based on Ruggles, C. O. The Need for Effective Regulation of Private and Government Power Utilities. An address delivered May 4, 1938 before the Twenty-sixth Annual Meeting of the Chamber of Commerce of the United States at Washington D.C. Pamphlet reprint by Chamber of Commerce of the United States, Washington D.C. pp. 3-4-5-6.

for the distribution of gas. The court took pains to point out that the gas company was no more obligated to serve prospective customers in the locality for which it held a franchise, than a manufacturing plant was obligated to sell products to all possible purchasers. The court expressed great surprise that one company should be expected to serve an entire city.

Our political theory of laissez-faire, in other words, was not limited to the comprehensive industries but was freely applied to the public utilities which at the outset should have been recognized as natural monopolies, and regulated as such. It was years before the duplication of public utility plants in the same area was recognized as economic waste, but the fact that the name "consolidated" is in the present title of so many of our gas companies shows that consolidation did finally occur.

The same theory was applied to the building of railroads, legislators insisting on competition. Parallel railroads were built often so near to each other that engineers could exchange a plug of tobacco, and duplication of expensive terminals and other facilities was considered highly desirable. Not until the enactment of the Transportation Act of 1920 did we give the Interstate Commerce Commission the power to prevent the building of an interstate railroad if, in the opinion of that commission, the road had no economic justification.

Because the development of the electric utility industry came so much later than the gas and railroad industry

we had had ample opportunity to see something of the economic waste through the duplication of gas and railroad facilities, and it is unfortunate that we did not profit from that experience in the building up of the electric power industry. Instead we insisted upon competition as the best means of obtaining adequate service at reasonable rates. When the industry shifted from the use of direct current to alternating current it was possible to develop long distance transmission, thus making possible the large present day power systems.

In the late 90's Samuel Insull succeeded in convincing the people that electric utilities could best deliver good service if they were permitted to be operated as monopolies, and as such be regulated. The public thought it a fair exchange and the industry, by and large, has been run that way since about 1907.

3. Formation of State Commissions

"Following the lead in New York and Wisconsin beginning about 1907 a number of states within the next ten or fifteen years abandoned the theory of competition as a means of regulation, and organized state commissions with power to grant or refuse certificates of public convenience and necessity, and with certain powers over other aspects of the public utility industries." (1)

The State Commission in Massachusetts, known as the Department of Public Utilities, has regulatory authority

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(1) Ruggles, C. O. The Need for Effective Regulation of Private and Government Power Utilities. op. cit., pp. 14.

over gas and electric, water, railroad, street railway, and telegraph companies. It consists of five members, one of which is appointed each year by the Governor of the Commonwealth, with the advice and consent of the council. The Governor designates one of the Commissioners as Chairman. The Commissioners cannot be in the employ of, or own stock in any gas or electric, water, railroad, street railway or telegraph company. (1)

The general regulatory functions of the Massachusetts Department of Public Utilities in regard to electric light and power companies, consists primarily of requiring that books and accounts be kept in a manner prescribed by them, that no securities be issued except with their approval, that rates charged for service are fair, that no merger or consolidation be effected without their approval. The Commission hears complaints of customers aggrieved because of their inability to settle their difficulties with the management of the operating companies, often suggesting the course of action that should be taken in specific cases. There are times when the operating company hesitates to extend its lines into sparsely settled territory because of lack of return on the investment, and the Commission may decide that the company should extend its lines.

During the 1920's the Commission allowed an operating company to increase its capital stock or to sell bonds without much question, but today due to laws which have been passed, every dollar of capital expenditure by an operating

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(1)Based on "General Laws of Massachusetts Relating to the Manufacture and Sale of Gas & Electricity by Private & Municipal Corporations." Brooks, Allan. 1929. pp. 9-10.

company has to be supported by detail showing the date of installation, location, description and purpose for which installed, and detailed cost. From this schedule the Commission can, if it so desires, send out field men to ascertain whether or not the statement is correct.

(1) The degree of control exercised by the various state commissions varies. The reorganized Wisconsin Commission since 1931 takes a hard stand with the utilities, while the Commission of Connecticut endeavors to gain results by cooperation. On the whole the utilities have not been troubled to any great extent by the commissions, because rates, in the eyes of the law, are based on the amount of return they earn on the company's capital, regardless of the response of the public. There is, however, much difference of opinion as to whether the valuation of the property should be determined on the basis of actual cost, or reproduction cost, and on this point the Supreme Court feels that both elements should be considered in a fair appraisal. This doctrine has enabled companies to reappraise their properties upward with the general price level, and thus resist rate reductions.

With the development of the holding company, and the increasing amount of electric power transported across state lines, a problem has arisen in regulation which in recent years has become increasingly acute. "The holding company has avoided state regulation on the ground that it is not a public utility. Though the local operating companies are subject to commission

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(1) Based on "Washington and Power." Fortune, XVII. op. cit., pp. 128.

regulation the transactions between the operating company and the holding company or one of its affiliates is not subject to full control, since a commission cannot examine the books of the latter to determine the fairness of such transactions. As these are clearly between interested parties the presumption of fairness which is applicable to dealings between independent parties does not exist. The difficulty is further aggravated by the character of the transactions, which are as a rule difficult to evaluate, particularly the charges for engineering, management, and financial services. An additional difficulty arises with respect to the issuance of securities by the holding companies. In many states the security issues by operating companies are closely supervised. Thus the holding companies, with which the credit of the operating company is linked, are unsupervised, a fact which has frequently led to inflation with its repercussions on rates and on quality of service." (1)

"Many State Commissions have not assumed to exercise many obvious powers which they possess over these holding companies, and which can be enforced by appeal to the courts when necessary. The Supreme Court has ruled that while a State Commission may not regulate interstate power....it can nevertheless regulate it at points of delivery." (2)

It was therefore unfortunate that regulation failed to keep step with the rapid strides made in the progress of the industry in the field of engineering and management. If such had been the case the "twilight zone" or "no-man's-land" that develregulation the transactions between the operating company and the holding company or one of its affiliates is not subject to full control, since a commission cannot examine the books of the latter to determine the fairness of such transactions. As these are clearly between interested parties the presumption of fairness which is applicable to dealings between independent parties does not exist. The difficulty is further aggravated by the character of the transactions, which are as a rule difficult to evaluate, particularly the charges for engineering, management, and financial services. An additional difficulty arises with respect to the issuance of securities by the holding companies. In many states the security issues by operating companies are closely supervised. Thus the holding companies, with which the credit of the operating company is linked, are unsupervised, a fact which has frequently led to inflation with its repercussions on rates and on quality of service." (1)

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. op. cit., pp. 408

(2) Shaughnessy, J. F. "The Case of the Holding Company-A Pressing Problem in Regulation." Public Utilities Fortnightly V; No.3 (February 6, 1930.) p.p. 140.

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(1) Bonbright, James C., Means, Gardiner C., Encyclopedia of Social Sciences. op. cit., pp. 408
(2) Shaughnessy, J. F. "The Case of the Holding Company-A Pressing Problem in Regulation." Public Utilities Fortnightly V: No.3 (February 6, 1930.) p.p. 140.

B. EVILS OF HOLDING COMPANY AS A RESULT OF LACK OF REGULATION

1. Security Issues and Accounting Practices

Inasmuch as holding companies are not at present recognized by the courts as being in themselves public utilities, they are only to a very limited extent subject to regulation by the public service commissions of the various states. Their security issues are therefore unregulated, except to a very limited extent by those states having blue-sky law commissions with jurisdiction over all corporate securities, but this has been extremely ineffective. Millions of dollars of securities that were issued and sold to the public prior to the stock market crash of 1929 would never have been allowed, if they had been subject to even a small part of the specifications of the Securities Exchange Commission which supervises the issue of securities at the present time. There is no question but that the financiers who conceived the creation of the giant holding companies, leaving the small investor with a security having little or no equity value, benefited greatly from lack of regulation by the commission. It is doubtful that the stock market crash of 1929 would have been so disastrous if there had been less of these securities issued by holding companies. The time for some kind of restrictions to their creation was long

overdue.

In the matter of accounting procedure, uniformity is not required as in the case of the operating companies, and their books are not open to inspection by commissions whose duty it is to regulate rates and services of the subsidiary companies. Prior and subsequent to 1929 one well-known holding company refused to reveal a statement of its business, and as its securities were widely held, conservative investment counsel advised the disposal of bonds because statements of operations were not available. The ordinary investor would hardly believe that this condition could be possible, especially since the operating companies controlled by the holding companies were required to submit full and detailed accounts to the commissions. Nevertheless, not only the ordinary investor but some of the commercial banks held these securities, the investment committee no doubt not being familiar with the fact that the existence of equity value had not been proven to a state commission. During this boom period the electric utility industry did not hesitate to capitalize the "future growth" of the business.

2. Management Contracts

Lack of regulation by state commissions allowed holding companies to subject operating subsidiaries to excessive charges for managerial and financial services. Various methods were used in determining the amount the operating

company should pay, a common one being based on a percentage of earnings. This method during the boom years yielded high profits to the holding company, resulting in increased operating expenses of the subsidiary, which in turn meant higher rates for service than would otherwise have been necessary to earn the rates permitted by the courts on the capital invested.

If the profits of an operating company exceeds a fair amount, the state commission has the power and the duty to insist that the rates be reduced to a point where they yield no more than a fair profit. The operating expenses include outlays representing transactions between the operating company and the holding company that controls its management. There is therefore an inducement for a holding company or management concern to charge a high price for the services and commodities which it sells to its subsidiaries, especially when a lower charge would magnify the apparent net earnings of the operating company and might subject it to a reduction of its rates.

It is generally recognized that this was a vicious practice, and not a high testimony to business ethics. Either voluntarily or from necessity of complying with the provisions of the Holding Company Act of 1935, the holding companies have discontinued doing a profit-making business with its own subsidiaries, so far as concerns charges for management service.

Mr. John I. Mange, President of the Associated Gas & Electric Company, announced December 28, 1938 the voluntary withdrawal from business with the Associated System on December 31, 1938 of the service organizations at 61 Broadway,

New York, which for some time have done financial, accounting, statistical, and corporate work for companies in the Associated System. Mr. Mange said: "The personnel of these organizations will be absorbed by the Utility Management Corporation, which supplies management services to Associated subsidiaries. The Utility Management Corporation is entirely owned by the operating companies in the Associated System, and renders services on a non-profit basis. Commencing January 1, 1939, it will furnish to Associated subsidiaries on a non-profit basis the services now supplied by these organizations at 61 Broadway." (1)

C. ESSENTIALS OF EFFECTIVE REGULATION

1. Uniform System of Accounts

"The first and most essential need is for a revision of the public service laws, subjecting the books and accounts of holding companies and other affiliated companies to the same publicity and the same uniform accounting provisions to which the accounts of operating companies are already subject." (2)

As holding companies were not recognized by the courts as being in themselves public utilities, they were only to a very limited extent subject to regulation by the public service commissions of the various states. Their accounts were not subject to uniform accounting provisions to which

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(1) Statement mailed December 28, 1938 by Associated Gas & Electric System to security holders.

(2) Bonbright, James C. "The Evils of the Holding Company." The Annals of the American Academy of Political and Social Science. Power and the Public. January, 1932. pp. 5.

the accounts of the utility operating companies were subject. Their books were not even open to inspection by commissions whose duty it was to regulate the rates and the services of their subsidiary companies.

2. Planned Consolidations

"The second need is for the development of rational plans of public utility consolidations under laws similar to the consolidation provisions of the Transportation Act, applicable to combinations by means of a holding company no less than to outright mergers and amalgamations." (1)

During the rapid growth of holding companies in the middle 20's they were free to bid against each other for any and all properties that they desired to control, without any thought as to whether or not they could be efficiently operated when connected with other operating companies. A glance at a map of almost any state, presenting in different colors the properties of each holding company group, would show that there has been no rational planning of the public utility map of this country.

3. Service Charges at Cost

"The third need is for the complete abolition of inter-company transactions yielding an unregulated profit to

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(1) Bonbright, James C. "The Evils of the Holding Company." op. cit., pp. 5.

the holding company or to an affiliated service company." (1)

As the holding companies or their affiliated corporations performed many different services for their operating subsidiaries, including managerial and financial services, it was the practice to make the charges sufficiently high to yield excessive profits.

Utility operating companies are entitled under the law to charge such rates as will yield them a fair return over and above their legitimate expenses of operation. If the return exceeds a fair amount, the public service commission has the power and the duty to insist that the rates be reduced to a point where they yield no more than a fair profit.

4. Commission Regulation of Holding Company Securities

"In most states...the operating companies may issue only such securities as are approved by a public service commission. This type of control was deemed necessary in order to prevent the flagrant over-issue of stocks and bonds of which the utility companies...were guilty." (2)

"With the securities of holding companies unregulated the stocks and bonds sold by them to the public might greatly exceed the par values or the book values of the securities of the subsidiaries which form the only assets of the holding company. This creates a public menace of serious character; for, to the extent that the capitalization of a

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(1) Bonbright, James C. "The Evils of the Holding Company." op. cit., pp. 5.

(2) Ibid., pp. 5.

holding company is inflated, its credit must suffer unless it is able to maintain interest and dividends on its over-issued securities by causing its subsidiaries to charge excessive rates. Whether in fact a holding company succeeds in causing its subsidiaries to charge such rates as will hold up the inflation, or whether it fails to do so, with the result that its fund-raising power is destroyed, the result is that the consuming public must suffer. In the one case, it must suffer by the payment of higher rates than would otherwise be necessary. In the other case, it must suffer by the failure of the utility industry to extend its services and to make improvements required by the rapid development of electrical technique." (1)

D. STATE VERSUS FEDERAL CONTROL

Due to the interstate nature of the business of the holding companies it may not be possible for state commissions to regulate national holding companies effectively without the aid of the Federal government, represented by a Federal commission. Nevertheless, there is apprehension that when the Federal government begins to regulate State Commissions will be displaced as in the case of the railroads.

There is also a feeling that with Federal regulation, even though it would prevent isolated abuses, the initiative, resourcefulness, mobility and efficiency of the holding companies would be definitely impaired, or in any event handicapped. Also, Federal regulation will inevitably cause friction and

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(1) Bonbright, James C. "The Evils of the Holding Company." op. cit., pp. 5.

confusion with state regulation, and in the final conflict the Federal powers will eventually dominate and control, thus more and more dwarfing regulation by and in the commonwealth.

If the case of Federal regulation of the railroads is an example of the effectiveness of Washington's skill in this regard, there is doubt in the minds of many interested in the problems of the holding companies as to whether Federal regulation would be a success. Invention and mechanical progress is bound to go forward, and the amazing growth of the electric power industry has been due to its willingness and ability to discard the time-tried old, and embrace the uncertain new, including, of course, the holding company. The story of the development and the introduction of the steam turbine is a classic of unhampered individualism. The world has been moving rapidly, whereas under the restriction of laws and theories, a Federal government body has had to decide, and having to decide has had to ponder, and sometimes ponder long.

"Wherever abuses or alleged abuses exist, publicity is a splendid corrective. It will not be long before the utility holding companies of the United States will be a business group without a secret. The Federal Trade Commission is seeing to that....as economists and engineers have worked diligently for upwards of three years upon the books, the plants, and the affairs of the holding companies and their operating subsidiaries; have gone back practically to the beginning and traced every transaction and policy practice and method, cost and profit or loss.... In this monumental record both sides will find

much to draw upon...but it is doubtful if grounds are found for Federal regulation.

"Most American cities still like to exercise certain powers over their streets and alleys, and they bargain and deal with their utilities by means of limited-term franchises...and they have the power to reach and discipline the holding company through the operating company.

"Again, we are compelled to remember that the states composing the Union have their own individual temperaments and traditions. Some are jealous of their rights relating to all matters within their boundaries; others are contrary-minded. Should not the states as a whole have something to say regarding Federal regulation?" (1)

In order to overcome the lack of power of the State Commissions to regulate holding companies, Congress may authorize the State Commissions to regulate companies, which although operating interstate, are engaged primarily in local distribution of electric service.

State Commissions selected by representatives of the people are known to the people, and therefore are familiar with local conditions, and they would be in a better position to enforce Federal restrictions than a Federal commission. If the Federal government does not give the State Commission Federal powers there should at least be a division of the work of

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(1) Hodge, William H. "A Defense of the Holding Company." The Annals of the American Academy of Political and Social Science. Power and the Public. January, 1932. pp. 11-12-13

regulating between Federal and State tribunals in order to prevent overburdening the Interstate Commerce Commission on the one hand, and on the other completely destroying the exercise of regulation over local properties within the states which should be kept close to the people, otherwise regulation will become so complicated that the expense will become a hardship to small companies.

The years of experience that State commissions have had in regulating the operating companies should make them better qualified to regulate holding companies if given authority. Because of the size of the country, federal regulation on a regional basis has been recommended, which would produce more satisfactory results by obtaining the benefits of local intelligence upon the issues involved.

This might be accomplished by the formation of state compacts. The Constitution of the United States has a compact clause which permits the states concerned, subject to the approval of Congress, to undertake by agreement to deal collectively. The Colorado River Compact which became effective June 25, 1929 is operating successfully. It is an agreement between six states covering water rights, and its delegates meet with a representative of the national government. Such regionalization of our national government might be applied to the interstate holding company problem.

Since the subject of regulation is foremost in everyone's mind in regard to utilities, state commissions should be given power to regulate municipal plants, as at the present

time only about one-third of the states have such power to regulate important activities of municipal plants. In the last analysis the public has a right to expect that it will secure electric service at the lowest cost consistent with good service; therefore, regulation whether State or Federal should be applied to all power utilities regardless of mode of ownership or operation. Without such regulation the public will not be in a position to make an intelligent decision unless there is a type of regulation that will enable it to determine actual results. Managers of public projects should be free from political interference and control, and they should be removed only for cause and after a fair hearing, not as a result of change of political party.

Progress in public utility regulation will be made only when political parties agree to recognize the independence of quasi-judicial commissions and give them a real opportunity to make objective analyses of problems which are economic rather than political in character.

To secure effective regulation we should have commissions that are adequately staffed and so financed that their work will not be impaired during business depressions when legislatures are liable to make drastic cuts in their appropriations. In some states commissions are financed by a tax on the utilities rather than by legislative appropriations.

"If regulation is put on a fair and objective basis, utility operators, whether of public or private utilities, can have no just complaint if the regulation is of such char-

acter that it recognizes the vital difference between regulation interfering with management, and regulation holding management responsible for reasonable results. The management of both public and private power utilities should be permitted to exercise initiative in the actual operation of utilities, but some dependable standards of regulation must be provided by which we can appraise the results of management. This type of regulation should be a real protection to those able leaders in the utility industries who are willing to make their profits through greater efficiency in the management of operating companies." (1)

D. MISTAKES MADE BY UTILITIES

1. Undue Emphasis on Making Profits Through Financial Promotion

The competitive bidding among holding companies in the acquisition of an operating company often resulted in prices being paid for the properties greatly in excess of their real value. The judgment behind this establishment of value was often influenced by the conviction that the companies would grow as fast, if not faster, in the future than in the past. These properties were turned over to another holding company at a profit, and book values set up resulting in

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(1) Ruggles, C. O. The Need for Effective Regulation of Private and Government Power Utilities. op. cit.,pp.22-23

detriment either to the using or to the investing public.

It is contended that the investor desires, and is entitled to, just and reasonable rates; that there is no room for pyramiding values and operating costs in the public service; that these holding companies exact unreasonable service charges from the subsidiary operating companies to cover services rendered.

"It was the practice of Electric Bond & Share, in the course of putting it together, to write up the book value of the properties to a level nearer their potential earning power than their physical cost. Some of these revaluations were of the "horseback appraisal" variety, and some involved no appraisal at all. (In 1931 the whole Bond & Share system took write-downs of $441,000,000). Bond & Share also "sold" its engineering, construction, and financial services to its subsidiaries at a non-competitive price which in the heydey grossed the parent company between $6,000,000 and $10,000,000 a year and was a source of large profit. Bond & Share is by no means the only principal villain of the Federal Trade Commission's seven-year utility investigation; the investigation that provided the steam behind the Holding Company Act of 1935. In fact, when the government picked Bond & Share for its test case of the Act, it was deliberately picking a cleanly managed company. But it was also picking the perfect exemplar of the basic characteristics of the holding-company operation that Senator Wheeler and the other authors of the Act think the

industry will be better off without. And the chiefest of these is Section 11. Bond & Share calls it diversification, and the government calls it scatteration.

"....Bond & Share has....an excellent operating record, the rates of its companies have been steadily reduced even after the most sanguine write-ups. Its engineering service, while extraordinarily profitable, has probably been a bargain to the subsidiaries who were forced to buy it. Even though the individual companies are scattered, their lines have in many cases been integrated with those of their neighbors through power-exchange contracts when this makes for a saving. Above all, Bond & Share has sold securities in its subsidiaries behalf, more than $1,000,000,000 worth since 1920. In an active year like 1924 it was taking bonds and preferred stock to market at the rate of four new offerings a month. By virtue of the Bond & Share hallmark, the marketability of the operating companies' securities has been much increased. Where, if not through Bond & Share, would a utility in Coalville, Utah, get enough capital to serve its little public? All this and more Bond & Share has been able to do because the operating companies, taking their diversified ups and downs on farflung fronts, from copper in Montana to steel in Birmingham, average out a safe and steady profit.

"Specifically, says the government, the extra marketability that diversification is supposed to create for the operating companies' securities is something that the operating companies have not, in fact, been able to cash in on. Bond &

Share, having first invested in the operating company equities, has then sold the operating bonds to the public. It has then placed the equities in intermediate holding companies and sold its debentures and preferred to the public- not to provide funds for the operating companies, but primarily to recoup (sometimes to double) its own original investment in the equities. Thereafter it holds just enough of the intermediate equities to assure itself of control. Instead of helping the little operating companies to do more much-needed equity financing, Bond & Share in fact removed their equities from the market and then befuddles the market with those of its intermediate holding companies and its own, which are far more speculative. Between 1929 and 1936 only thirty-six utility operating companies went into receivership or 77b, their total capitalization being $346,000,000. But fifty-three holding companies went under, and their total capital was $1,693,000,000!" (1)

In the write-down of $441,000,000 there disappeared the savings of thousands of small investors, who, being unaware of the fantastic pyramiding of values felt that they had an investment in the public utility industry that would not only pay them a fair return, but over a period of years would increase in value, and be a nest-egg for a rainy day.

It is little wonder then that holding company practices fell under the ban of public condemnation, and that there is a wide-spread demand for regulation.

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(1) "Washington and Power." Fortune, XVII (February, 1938) pp. 136-138.

2. Assumption by Utilities of Monopoly of Market

(1) Because the public permitted consolidations of operating companies, the utilities assumed that they had a monopoly of their markets. They were encouraged in this belief by court decisions upholding their legal right to a fair return on the so-called fair value of their property. Too much time was therefore spent trying to prove their legal right to a very high rate base. Too much time was spent in trying to make substantial gains through the issue of securities up to and even beyond what could be established as the utility's legal value. Faith in high rates as a means of increasing revenue continued until the need for a differentiation in rates to secure a full development of the market asserted itself.

It is the duty of the power company, whether privately or publicly owned, to secure a complete development of the market, thus obtaining the lowest possible unit costs of power. The large power customers can usually select an alternative source of power if they are not satisfied with the company's rates and service, or install their own power plants. Such customers should be served under whatever form of rate may be necessary to secure the business, provided such rates will yield the power company something above the increment costs involved. If power is not thus sold to these large customers, the best interests of domestic consumers themselves will be disregarded.

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(1) Based on address Ruggles, C. O. The Need for Effective Regulation of Private and Government Power Utilities. op. cit., pp. 6-9.

VI. GOVERNMENT COMPETITION - FEDERAL

A. ECONOMIC ASPECT

(1) The government, in an effort to conserve natural resources, and formulate plans for national defense, flood control, soil conservation, navigation, and irrigation, finds that as a by-product of these activities there is surplus electric power. Private companies should have no valid objections to the marketing of this by-product power, but there should be an equitable adjustment of marketing areas between the private companies and the government, otherwise economic waste will result.

Also, this by-product power resulting from these government projects should in no way be a yard-stick on the cost of power to other plants, whether public or private, if the latter generate power as their main product.

Therefore, when the government develops one of these multipurpose projects in a given geographical area, it should be made clear to the public, that no power company, however efficient, can compete with the by-product power that the government will have at its disposal. There should also be no division of the market if one company can serve the area more economically, and the private utilities operating within the marketing area of the government project should be

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(1) Based on address Ruggles, C.O., The Need for Effective Regulation of Private and Government Power Utilities. op. cit., pp. 11-12.

purchased on some equitable basis, and thus eliminate all competition within that area.

This method of handling surplus power of government projects should bring no quarrel with utility men or the public. Unfortunately, politicians have chosen to use this surplus power as a "yard-stick" by which to measure the rates of companies near enough to be effected.

B. POLITICAL ASPECTS

1. New Deal Doctrine

(1) New Deal politicians are firm in the belief that electric power is as much a general necessity as water and the mails. President Roosevelt feels that the government has a right and it is its duty to lower the barriers that pricing for profit has erected between electricity and the people, and legislation advocated by him consists of four principal aims:

(a) Rationalize and regulate the interstate holding company systems which were operated under their own financial rules until the passage of the Public Utility Act of 1935.

(b) Increase the amount of cheap electricity by building federal power dams: T. V. A., Bonneville, Grand Coulee, and others.

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(1) Based on Article "Washington and Power." Fortune, XVII (February, 1938) pp. 62-131.

(c) Spread the use of electricity through projects like R. E. A. which lends money to rural groups who want to build their own distribution lines.

(d) To force down the cost of electric current by competitive example, the T. V. A. Yardstick.

The T. V. A. power program, while legally incidental to the development of the valley for navigation and flood control, was designed to prove or disprove the theory that private electric rates, because of the stabilizing influence of regulation and monopoly, have remained unnaturally high. When T. V. A. began in 1933 the average national residential use, at a five and one-half cent rate was less than 600 kwh. per year. Many operating companies did far better than this with promotional rates; refrigerators were aggressively sold; and there were a few mild merchandising efforts behind the electric range, hampered however by the fact that many utilities also sell gas. But there was little or no price merchandising in the sense that a department store would understand the term. There was never in short, any risk taking. Most rate cuts followed, rather than preceded an increase in profits. It was counted bad management to experiment with rates to the point where there was a chance of diminished gross revenue; for a rate cut, once made, is politically impossible to rescind. It was reasoned that if an industry's profits are limited, it should not be expected to stand the risk of loss. David Lilienthal, director of the

T. V. A. called it "a complete business stalemate, and a vicious circle of high rates and low use."

The sponsors of the T. V. A. meant to break this circle, and proposed to demonstrate that the average consumer, if encouraged by really low rates, will respond with a higher use of current than hidebound financial managements have believed possible; to quote Mr. Lilienthal again "to demonstrate not only the social desirability but also the business wisdom" of cheap power.

2. Tennessee Valley Authority

(a) History

"In that portion of the Tennessee River flowing through northern Alabama, there are rapids known as Muscle Shoals. In 1909 or 1910, the power companies which were then engaged in the pioneer development of the Southern States, acquired a site for the building of a hydro-electric plant at Muscle Shoals.

"The Congress of the United States, however, in 1916 determined to build at Muscle Shoals, plants for the manufacture of nitrates, an indispensable element of high explosives and to build a dam and electric generating plants in connection therewith. The power companies gave to the Government for the sum of $1.00, their property at Muscle

Shoals which had cost them $500,000. The nitrate plants were completed in 1918 at a cost of sixty-five million dollars.

"The dam and power plants were finally completed in 1925 at a total cost of sixty million dollars. The nitrate plants were absolutely valueless upon completion by reason of the intermediate development of new methods of manufacture and new sources of supply of nitrate....Recently they were declared by the Federal Government not to be worth even salvage value....

"Since the completion of the power plants, the power companies have offered repeatedly to lease them or buy their entire output on a basis which would have yielded the Government 4 per cent on its investment of sixty million dollars or $2,400,000 per year. The Government rejected these offers and thus additional millions of taxpayer's money were wasted.

"Upon the passage of the Tennessee Valley Authority Act, in June 1933, these power plants, which had cost approximately sixty million dollars, were put upon the books of that organization at approximately twenty million dollars, thus eliminating forty million more of the taxpayer's money."(1)

(b) Purpose

The idea behind the T. V. A., was that it would

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(1) Willkie, Wendell L. Who Pays the Bills for T.V.A? An address made over the N.B.C. radio network, March 5, 1936. Reprinted by Edison Electric Institute, 420 Lexington Ave., New York. pp. 2.

establish a yardstick for electric rates. The ideal of the yardstick was set forth by Arthur E. Morgan, Chairman of the Tennessee Valley Authority, in The Forum in March 1935, in the following words:

> "The President wishes that somewhere in America there should be a case of public generation, distribution, and sale of power. He is of the opinion that power developed in this country ought not everywhere be a public project, that private development of power has decided advantages and ought not to be abandoned. But he feels there ought to be here and there cases of public ownership which can serve as comparisons. And if they are to serve as comparisons, they must be open and above board, with nothing hidden. They must be fair, with no special arbitrary advantages. They must pay taxes, just as private utility companies must do, and every reasonable charge, if they are to provide us with a fair comparison."

A fair-minded person could take no exception to this statement, but the actual operations of the T. V. A. presents a very different picture.

(c) The Agricultural Division of the T. V. A.

(1) The Agricultural Division of the T. V. A. is committed to improve the land in the Tennessee Valley, and cooperate with the farmers in an effort to improve their general living conditions.

These farmers are too poor to buy fertilizer, and if good crops are to grow indefinitely, the soil needs plant

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(1) Based on Article "T. V. A. I: THE WORK." Fortune, Vol. 15, 1935. pp. 150.

food. Lime, potash, and nitrogen can be returned to the soil, but phosphorous is not so easily obtained. T. V. A. in cooperation with the farmers is developing some of the phosphate beds in the valley, and manufacturing superphosphate at Muscle Shoals, Nitrate Plant, No. 2. This superphosphate is distributed free to selected demonstration farms throughout the valley.

The program also includes assistance in the development of grazing lands and of livestock raising, breaking up the one-crop system, and distributing the farmers upon land they can farm.

The Tennessee Valley Association Cooperatives was created in March 1934, to handle F. E. R. A.'s $300,000 allocation. The cooperatives formed were primarily in canning and the exchange of farm products, but plans were under way to develop crafts and the utilization of mineral resources and forest products.

As the power issue is of most interest to the public at the present time, there is little publicity given to this commendable part of the T. V. A. program.

(d) Hidden Costs at T. V. A.

"In the year 1935, the T. V. A. paid taxes in the amount of $16,900 on property and funds totalling $384,000,000. If it were privately owned and operated, it would be paying on

that property and funds from nine to ten million dollars in taxes. Yet there is to be "nothing hidden" and there are to be no "special arbitrary advantages." (1)

As T. V. A. has the whole taxing power of the United States behind it, it can get an appropriation any time at 3½%, which is much less than a private utility can borrow money for.

"Federal government competition has one great advantage over private enterprise in one very important respect; interest on the investment is ignored in its published accounts.

"When a power company builds a dam, it usually has to borrow money to finance it. Bonds are sold and interest is paid as the individual coupons are presented. Until the plant begins operation, the interest which has accrued during construction is commonly added, along with other "overhead" items, to actual construction expenditures and constitutes an integral part of the investment upon which the project is expected to yield a return. After the plant is in operation, interest must be provided out of the revenues of the enterprise.

"Regardless of the fact that bonds have been sold, the cost of a Government enterprise....only represents the actual out-of-pocket payments for the job. Interest on any specific project disappears into that convenient catch-all entitled "Interest on the Public Debt"......This is very convenient for several Government operations, in that it permits them to give out reports showing operating profits, while

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(1) Willkie, Wendell L., "Lessons" of the T.V.A. The Financial World (June 3, 1936) Reprinted by Edison Electric Institute 1936. Pamphlet pp. 1.

fixed charges are buried among the vast general expenditures of the Treasury Department." (1)

Preliminary studies for Muscle Shoals were begun in 1918, but the project was not completed until 1925, at which time it began to produce electricity which was sold under short-term contracts to Alabama Power Company.

During all this time interest was accumulating at the rate of 4¼%, as the cost of the dam was borne out of war loans, and that was the rate paid on them. At the time the T. V. A. inherited Muscle Shoals, the investment applicable to electricity was $51,279,588, of which $37,000,000 was actual construction cost, and $14,279,500 was accumulated interest less operating income from day-to-day sale of power to Alabama Power Company.

Subsequent operations are matters of public record and are found on Page 66 of the Annual Report of the T. V. A. for 1935 with the important and significant exception that no charges for interest amortization or depreciation are made. Further calculations as to the taxpayer's present investment are shown in Table No. V.

This table by no means covers all the cost to the taxpayer. There are, in addition, the charges incurred by the Treasury Dept. in procuring the funds which were spent on the project, and the expense of the accounting services rendered by the Comptroller General's office. No allowance has been made for depreciation on a property which has been in operation for

ten years. No consideration has been given to sinking funds or to the amortization of the original investment.

TABLE NUMBER V.

EXTRACT OF ANNUAL REPORT OF T. V. A. for 1935

	Fiscal Year Ending June 30, 1934		Fiscal Year Ending June 30, 1935
1. Investment at beginning of year	$51,279,588		$53,995,607
2. Expenditure for plant & equipment(a)	1,874,319		1,984,329
3. Interest rate (b)	3.25%		3.00%
4. Interest on Item 1	1,388,823	(d)	1,619,868
5. Interest on Item 2 (c)	25,382		29,765
Total Interest	$1,414,205		$1,649,633
Credit: power operating income (e)	572,505		183,935
Net Deficit for Year	$ 871,700		$1,465,698
Investment End of Year	$53,995,607		$57,445,634

(a) "Net investment in programs: Electricity (plant and equipment)" Supporting Statement No. 2 B.
(b) Average rate paid on Government funds during year.
(c) Computed on half of expenditure.
(d) Ten months only.
(e) "Total reserve, for amortization, construction, interest and other purposes" - Supporting Statement No. 2A.

(1)

"Nevertheless, a deficit of $1,465,698 is sufficiently large to negate all claims of the T. V. A. as a "going concern." In 1935 a total of 100,681,142 kwhrs. were sold from Muscle Shoals. Divided into $1,465,698, this gives 1.45 cents for every kwhr. sold and constitutes the bonus given

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(1) Hidden Costs at Muscle Shoals. Bulletin by Carpenter, William M. op. cit., pp. 2-3.

by the taxpayers of the United States toward the furtherance of the T. V. A. in that year." (1)

This deficit is small compared to the deficit predicted by Dean Moreland, of the Engineering Department of the Massachusetts Institute of Technology, in testimony given before a congressional investigating committee on November 17, 1938 in Washington, D. C.

"The T. V. A. power program will cost the taxpayers of the United States $10,352,000 a year to meet the deficit it will produce when the proposed 11-dam system is completed and in full operation under the present T. V. A. "yard-stick" rates and under a proper allocation of costs.

"Dean Moreland, a Boston consulting engineer, is the chief and only expert witness called by the Commonwealth & Southern Corporation to present the case of the private utility companies against government competition in the sale of electric power.

"He also testified that if T. V. A. had to pay taxes, interest and other costs which utility companies have to pay, its annual deficit would be $20,999,000 for the country's taxpayers to meet.

"He asserted that the T. V. A. "yard-stick" rates, now much lower than company rates, would have to be increased 43 per cent. to enable the government and the taxpayers to break even. He said that a private company would have to charge 87 per cent. more than T. V. A. rates to break even in view of

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(1) Hidden Costs at Muscle Shoals. Bulletin by Carpenter, William M. op. cit., pp. 2-3.

the subjection of private enterprise to costs which he said the general treasury, and through it the taxpayers, paid for T. V. A."(1)

When T. V. A. was first proposed it was to be a laboratory experiment the results of which could be accepted by the electric industry. Mr. Lilienthal, Director of T. V. A. chose to give the general public the idea that T. V. A. rates are an absolute measure of what fair rates everywhere should be.

The real quarrel with fair-minded utility men is over the use to which the "yardstick" is put in connection with retail rates. T. V. A. itself sells power only at wholesale, to communities, cooperatives, etc. Its wholesale rate of five or six mills, while based on a niggardly power allocation of the total cost of the dams, is not extravagantly low. But T. V. A. imposes by contract on the distributing agencies who buy its power that certain retail rates be charged. These rates are such that private utilities in the neighborhood cannot compete with them, and consequently millions of dollars of securities are jeopardized.

(e) Lessons Taught by T. V. A.

The real lesson the T. V. A. teaches is that public ownership is not fair and that the so-called "yardstick" it creates is really but a collection of special arbitrary advantages. The low rates T. V. A. has succeeded in establishing

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(1) Boston Herald. Big Yearly Deficit for TVA Predicted. November 18, 1938.

are largely due to special advantages, subsidies and grants which private companies are not able to avail themselves of. It is because the T. V. A., like the Cuckoo Bird, has not built a nest of its own, but has seized the nest of another bird.

"If the Federal Government were to give the private utilities of the Tennessee Valley as well as those elsewhere in the United States the subsidies and grants and special advantages such as relief from taxes and low cost of money made available to the T. V. A. and the municipalities it serves, the privately owned utilities could and would put in force rates for electricity materially lower than those now charged by the T. V. A. and the municipalities in which it furnishes electricity wholesale." (1)

In order to control the operations of T. V. A. Mr. Willkie proposes that Congress require:

> "First- That the TVA in its utility operations be required to pay taxes at the same rate and on the same basis of property valuation as the private utilities.
>
> Second- That it be required to keep a uniform system of accounts such as is required of the utility companies.
>
> Third- That it be required to charge rates for the electric energy which it sells so as to produce a fair rate of return on the value of the property which it uses in that business.
>
> Fourth- That before it duplicates the transmission or distribution lines of companies already in the business that it be required to condemn the property thus sought to be duplicated and pay the companies owning such properties the value of the same as determined by a just tribunal.

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(1) Willkie, Wendell L. "Lessons" of the T.V.A. op. cit. pp.1-2.

> "Fifth- That it be required to charge uniform rates to all customers of the same class and file such rates in the same manner as utilities are required to do, either with the public utility commissions of the states or the Federal Power Commission at Washington." (1)

These proposals were opposed by the T. V. A. at the last session of Congress, so it would appear that the Federal Government is really not interested in establishing a fair "yard-stick."

That the operations of the T. V. A. are destructive to private utilities operating in its vicinity is brought out in an article by J. C. Guild, Jr. President of the Tennessee Electric Power Company. He states that Mr. Lilienthal strives to convey the idea that the power program of the Authority has been helpful rather than harmful to the private utilities operating in the Tennessee Valley, and the story has been spread throughout the country as a smoke-screen designed to conceal from the public mind a program of ruthless warfare and destruction which the T. V. A. has been waging against the private power industry in the Valley ever since the Authority's inception.

Mr. Guild does not agree with Mr. Lilienthal, as the securities of the Tennessee Electric Power are selling as much as 42 per cent below par, when securities of operating companies outside the Valley are selling at above par. "Not being content with entering into contracts to supply the power for municipally owned systems, and entering into contracts for

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(1) Willkie, Wendell L. Who Pays the Bills for TVA. op. cit. p.3.

for new industrial power business because of its low subsidized rates, and actually advancing the money and doing the construction work for rural electric cooperative associations, the T. V. A. ever since its inception has carried on a systematic and all inclusive program of propaganda designed to engender in the minds of the people of the Valley, and in the minds of the utility's own customers, employees, and stockholders, a spirit of distrust, dissatisfaction, and hatred for private enterprise in the power business. Moving pictures, direct mail, newspaper and magazine publicity, demonstration showrooms, nothing has been overlooked by the publicity experts employed by the T. V. A. to promote the Authority's campaign. Invitations to address public gatherings have been seized upon eagerly by the Authority's directors as opportunities to promote public ownership of power facilities. Local communities have been encouraged to hold referenda in favor of municipal ownership in order to buy T. V. A. power or to force the sale of local private utility systems at distress prices, or to duplicate the existing distribution systems with the aid of gifts from the Federal Treasury.

"The T. V. A. is constantly and continually promoting municipal ownership in the territory served by the Tennessee Electric Power Company. Grants are given by the Public Works Administration, and has offered to the city of Lewisburg an outright gift of $45,000, to the city of Lenoir City, $45,000, to the city of Columbia $92,000, and has held out a similar and correspondingly larger grant to the city of Chatanooga and grants to other cities served by Tennessee Electric." (1)

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(1) Guild, Jo. C. Jr. "How the T.V.A. Really Hurts Private Utilities." Public Utilities Fortnightly(July 2, 1936) Reprinted by Ed. Electric Institute, 1936. pp. 4-5.

An item in the Boston Herald December 3, 1938 states that, "The National Power & Light Co. elected today to fight the encroachment of Federal Electric Power by meeting Tennessee Valley Authority rates in the Memphis area. The company announced a slash in rates averaging about 33 1/3%.

"At the same time it left up to the stockholders a decision on whether to accept a $17,385,000 offer by the city of Memphis for the gas and electric properties of its Memphis Power & Light subsidiary. The company also announced it stood ready to negotiate with T. V. A. for power to supply Memphis and adjacent territory.

"....It was the first time in the recollection of utility men here that a power company had chosen to do battle with the T. V. A. on the basis of the government agency's "yardstick" rates.

"Memphis began last summer building its own distribution system for sale of T. V. A. power, undercutting private rates. Construction was interrupted when a tentative agreement was reached September 30 for the purchase of the utility's electric property. The field was re-opened later to include gas properties and finally ran into today's decision for competitive showdown.

"....The company said its outstanding securities represent an investment of $28,876,000...and the city's offer fell short of property investment by $11,491,000."

T. V. A. has far exceeded the original intentions for which it was created, and such destruction of property values

and the methods used in bringing it about would appear to be prompted more by vindictiveness, than by economic necessity.

(f) Subsidies from Federal Taxpayer to Communities Served by T. V. A.

A summary of the advantages enjoyed by the T. V. A. because it is a Federal project rather than private enterprise would be somewhat as follows:

1. Tax Subsidy. This is the largest subsidy enjoyed by publicly owned utilities. Municipal, state federal, and the 3% tax on gross revenue amounts to 14 cents on each dollar of gross revenue.

2. P. W. A. Loans and Grants. The Public Works Administration offered to cities, towns and power districts a free gift of 45 per cent of the cost of power projects, including the purchase or construction of retail distribution facilities, and it offered to loan money to cover the remaining 55 per cent of the cost of the project at an interest rate of 4%. For a time this rate was 3%. Most companies would have to pay more than this.

3. Distress Prices for Power Systems. T.V.A. bought the Mississippi Power Company at about 60 cents on the dollar. T.V.A.contemplates selling this same property to municipalities or county associations at the same distress figure which amounts to an actual subsidy.

4. New Business Development Subsidy. The Electric Home and Farm Authority was created for the purpose of educating customers in the T.V.A. area in the use of appliances, through demonstrations and sales drives. New business costs to a privately owned electric company is an important item in operating expenses.

5. Subsidies for Engineering, Accounting, Maintenance and Operating Expense. From operating statements it would appear that T. V. A. is assuming many of these expenses which belong to the companies they serve. (1)

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(1) Based on Bulletin- Subsidies from the Federal Taxpayer to Communities Served by the TVA. Bennion, H. S., Asst. Managing Director, Edison Electric Institute. July 1936. pp. 7.

3. EXTENT OF FEDERAL GOVERNMENT FINANCED COMPETITION

"The (Federal) Government's stake in the power business has increased rapidly during the last five and one-half years.

"Prior to 1933, with the exception of the Sheffield and Wilson plants, the (Federal) Government financed projects were limited largely to reclamation projects, and the amount of by-product power was relatively small, and used in irrigation operations, or sold direct to operating utilities, or distributed direct to nearby farmers. None of these projects competed with the existing private companies for their markets.

"Today the (Federal) Government financed plants competing directly with privately owned plants number approximately 140. The ultimate capacity of these projects is estimated at almost 7,000,000 kilowatts, equal to more than 20% of the capacity of all the private company plants in the country.

"It is estimated that more than half the government's investment in the power field is in these new generating plants that have been constructed in areas where there is ample power supply from private utilities.

"Through construction of new power plants and loaning money to construct transmission lines and competing distribution facilities in cities and towns which are centers of power demand, the Federal Government has brought about situations where the private companies are faced with either selling out at sacrifice prices practically dictated by the purchaser, or the alternative, destructive competition.

"The electric properties of the Tennessee Public Service Company, Memphis Power & Light Company and Holston River Electric Company, operating subsidiaries of National Power & Light Company, in which Electric Bond & Share has a large investment have already been sold at great sacrifice, and negotiations have been entered into for the sale of West Tennessee Power & Light Company.

"The Carolina Power & Light Company, another subsidiary of the National Power & Light Company built its Waterville hydro-electric plant, costing about $14,000,000, to supply power to its Western District, also to the much larger load of the Tennessee Company, T. V. A. has taken over the Tennessee Company's load resulting in a great loss to the Carolina Company, and it will be a considerable time before the Carolina Company will be able to dispose of this power elsewhere.

"In Texas, a series of dams have been financed by the Federal Government on the Lower Colorado River, and offers have been made to municipalities of Federal funds to build competing distribution facilities with the Texas Power & Light Company, a subsidiary of American Power & Light Company, with a large interest owned by Electric Bond & Share. Consequently the Texas River Power Company has offered to sell at actual investment price to the Lower Colorado River Authority practically all of its electric properties in sixteen counties of the State.

"In the Pacific Northwest, and in Nebraska, where large new sources of power are being developed by expenditures of Federal funds, the private companies are faced with similar problems.

"During the period of construction, T. V. A. being the only Federal project in operation, private utilities are being required to expend large amounts of money for new facilities to take care of the service in districts where Federal projects are already in the making. There is no assurance that these new capital expenditures will provide a return on the investment.

"At this writing government competition with the private utilities is by far the most serious issue facing the industry. (1)

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(1) Statement of Groesbeck, C. E. Annual Meeting of stockholders of Electric Bond & Share. October 13, 1938.

VII. H. R. 5423 "PUBLIC UTILITY ACT OF 1935"

A. BRIEF HISTORY

1. Rapid Formation and Growth of Holding Companies

The utility industry from 1920 to 1929 expanded by leaps and bounds, and the mad scramble by holding company management for acquisition of properties, often at fantastic prices, resulted in tremendous profits for the investors owning the operating company securities. As a result, the speculating public sought eagerly any opportunity to purchase utility stocks in a desire to make money, innocently believing that these holding company securities had the same equity value as operating company securities. The stock market crash of 1929 reduced the value of these securities to practically nothing, thereby wiping out the savings of all classes of people.

2. Federal Trade Commission Investigation

The effects of the decline in the value of these securities was so far-reaching that the attention of the representatives of the American people in Congress was called to the need for an investigation of the operations of holding companies in the electric light and power field. The investigation of the Federal Trade Commission lasted seven years, and the results are contained in eightyfour volumes, citing many cases of scandals

portraying the inherent temptations that even financiers could not resist.

3. Remedial Solution Proposed by Wendell L. Willkie, President of The Commonwealth & Southern Corporation

Conservative leaders in the industry were willing to grant that there had been abuses of power by the holding company promoters, and they were willing to cooperate with the government in an attempt to correct such abuses through regulation. In December, 1934, Mr. Wendell L. Willkie, President of The Commonwealth & Southern Corporation which operated in territory adjacent to that of the T. V. A. made an attempt to work out with responsible Federal authorities a solution of the utility question. He felt that what he proposed would meet the objectives of the Administration, and still allow the utilities to continue their development. The proposal contained the following points:

"1. That in the territory of any utility company which had a base rate schedule and supplemented such with an objective rate, all satisfactory to the Federal Government, the Federal Government would not build duplicate transmission or distribution systems or give and loan money to cities to do so;

2. That utility companies as a group were to spend for capital construction, in anticipation of necessary future needs, a minimum in the years 1935 and 1936, of twice their then anticipated requirement;

3. That the Federal Government should complete the hydroelectric dams which were in course of construction, where necessary to prevent economic waste; that the utility companies operating within transmission distance of such hydro electric plants were to buy and absorb into their systems as rapidly as possible all energy generated by such plants; that until the absorption of the output of such plants they would not build additional generating plants of their own; that they would pass on to the ultimate consumer the entire sav-

ing between the price which the Government would charge such companies for such energy and the cost to such companies of generating their own power- thus giving to the ultimate consumer the full benefit of any subsidy that the Government desired to make in connection with such hydro developments;

4. That the utilities would spend a substantial amount of money on rural lines whether the same were profitable or not;
5. That there should be created a national commission composed of a representative of the President's cabinet, representatives of the leading manufacturers of appliances and of the utilities, and one or two outstanding citizens representing the public which would constitute a national electric commission for the electrification of America;
6. That arrangements would be made with manufacturers of electrical appliances on a large scale basis so that a minimum standard model of appliances such as ranges, refrigerators, etc., could be established and a minimum price thus obtained; that such appliances should be sold on long terms and arrangements should be made with the Federal Reserve System or the Reconstruction Finance Corporation for the large scale rediscount of such paper through the commercial banks;
7. That a utility holding company regulatory bill should be enacted which would eliminate and prohibit all of the alleged abuses existent in that field of endeavor, establishing a strict but fair regulation over the operations of such companies." (1)

This plan, if adopted, would have created in the first year of its existence, a minimum of three and a half billion dollars in business, by putting into use a substantial percentage of the excess funds in the banks of the country. This would have provided employment at a time when work and jobs were very much needed.

If the objective rate had been accepted the domestic consumers of electric energy in the United States would have used an additional two billion kilowatt hours and at no increased cost to them.

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(1) Willkie, Wendell L. The Public Utility Problem- Its Recent History and Possible Solution. Address Bond Club of New York. December 19, 1935, New York City. pp. 5-8.

(1) After numerous conferences with government officials, all of whom appeared to be very much interested, the plan was presented to those in final authority with the result that word came back that an act was to be passed declaring a "death sentence" for utility holding companies. This type of business organization was to be outlawed and exterminated, and utility operating companies were to be placed under regulation so stringent and rigorous that the prerogatives of management would repose thereafter in a Federal bureaucracy, with private initiative virtually abolished from this highly important, efficiently conducted American industry.

4. The Public Utility Holding Company Act of 1935

As a result of the findings of the Federal Trade Commission, on February 6, 1935, The Public Utility Holding Company Act of 1935 was introduced in the House by Sam Rayburn and in the Senate by Burton K. Wheeler.

In an interview presented over the radio February 17, 1935 Mr. Rayburn gives his reasons for sponsoring this legislation. He states:

"That this bill when enacted, will have the effect of rapidly freeing our power and gas companies from the ownership and control of holding companies. Generally the holding company leads to secrecy, mismanagement and, in some instances, to downright fraud. We want American business to be free from a control that is secret.

"The holding company has developed to where control is exercised through a maze of corporate relationships, impossible to be understood by an ordinary man. The holding company device has been pyramided to give a few small but powerful groups, control of the billions of dollars of the public's money invested in the utility industry. This has placed the great utility properties of the country in the control of men who themselves have only a small stake in their real ownership and who have shown neither prudence nor capacity in the management of these properties."

Senator Wheeler spoke over the radio on April 12, 1935 giving some of his views on the legislation:

"....The public utility holding company is a kind of high finance company which makes a business of acquiring control of the companies which actually run the electric light and power plants in your home town. Sometimes a single holding company run by a few insiders controls thousands of such electric light and power plants. Those thousands of electric light plants may be scattered all over the country, but the heads of the holding company run them for their own advantage from an office in New York, Chicago, or some other big financial center....

"Remember the public utility business is not a private business subject to the normal restraints of competition. It is a legalized monopoly given special privileges by local government to serve public ends. Regulation is supposed to protect the public consumer and public investor against that monopoly. But no local community and no State can handle these giant corporations with all their tremendous resources of money and lawyers and pol-

"The holding company has developed to where control is exercised through a maze of corporate relationships, impossible to be understood by an ordinary man. The holding company device has been pyramided to give a few small but powerful groups, control of the billions of dollars of the public's money invested in the utility industry. This has placed the great utility properties of the country in the control of men who themselves have only a small stake in their real ownership and who have shown neither prudence nor capacity in the management of these properties."

Senator Wheeler spoke over the radio on April 14, 1935 giving some of his views on the legislation:

"....The public utility holding company is a kind of high finance company which makes a business of acquiring control of the companies which actually run the electric light and power plants in your home town. Sometimes a single holding company run by a few insiders controls thousands of such electric light and power plants. These thousands of electric light plants may be scattered all over the country, but the heads of the holding company run them for their own advantage from an office in New York, Chicago, or some other big financial center....

"Remember the public utility business is not a private business subject to the normal restraints of competition. It is a legalized monopoly given special privileges by local government to serve public ends. Regulation is supposed to protect the public consumer and public investor against that monopoly. But no local community and no State can handle these giant corporations with all their tremendous resources of money and lawyers and political power which this holding company device has assembled. We are now testing whether even the Nation itself is strong enough to stand against them.

"The truth is there is no scientific reason at the present time why we need holding company systems sprawled over the whole United States. We do not need or want utility combinations that are not confined to the service of an area where they are needed to tie together a group of related operating companies. The only death sentence the bill pronounces on holding companies is to say, "You've got to trim down to what's absolutely necessary to serve the public if you want to go on doing business in this country. You've got to do that for the sake of the consuming public. You've got to do that for the sake of the investing public who have always mistakenly thought that through you they were investing in a sound and useful and regulated operating business."

That there is truth in some of these statements cannot be denied, but there is also political heat. Nevertheless a great deal of strength was added to the cause by President Roosevelt. Having indicated his disapproval of the activities of the utility industry when he was Governor of New York, he promised when campaigning for the office of President of the United States that if elected he would see that laws would be passed to curtail further development of holding companies. In a surprise message to Congress on March 12, 1935, he transmitted a report of the National Power Policy Committee, and defended the general principles of the Administration's program for the regulation of public utilities.

Declaring that he is as much opposed to "private Socialism of concentrated private power" as he is to Government Socialism, the President asserted that the one is as dangerous as the other, and that the destruction of private Socialism "is utterly essential to avoid Government Socialism." The objective of the Administration's public utility program is to take the benefits of the local operating utility industry "out of a few financial centers and give back control and those benefits to the localities which produce the business and create the wealth."

As the President sees it, the utility holding company with its present powers must go. He feels that it is a device which "does not belong to our American traditions of law and business." It permits too easy abuses, and too great concentration of wealth and economic power.

(a) Main Purposes of the Act

As defined by the Holding Company Act, a company that owns and controls ten per cent or more of the voting securities of an operating utility is a holding company, and must register with the Securities Exchange Commission if its business is interstate. It then becomes subject to many important rules, notably Section 11. Section 11 is real death to the exaggerated pyramid; it forbids more than one intermediate holding company between the operating company and its top parent, the so-called "grandfather clause." It also limits each holding company to the control of a single regionally integrated system.

It was the purpose of the Act to require that holding companies immediately register and be responsible to the Securities Exchange Commission for all their activities until final dissolution in 1940.

Mr. Rayburn outlined the procedure of the Federal Government in bringing this about. In 1933, Mr. Rayburn introduced and Congress passed the Securities Act which regulated and in many instances controls the issuance of securities. From the Securities Commission, prospective buyers can secure facts about any security that he contemplates buying. In 1934, he introduced and Congress passed the Stock Exchange Bill which controls trading in securities. Through the 1933 Stock Exchange Bill and the proposed bill to regulate holding companies, a circle of Federal control is completed, which will be fair and just to those controlled, and bring about fair dealing by them with the public. Five years was planned by Mr. Rayburn for dissolution of undesirable holding companies so that the matter would not be allowed to drag on indefinitely. Most of the regulation provided for in the bill is simply control of a process of rearrangement of properties and simplification of securities under the supervision of the Securities Exchange Commission so that both the Consumer who buys light and power from the local companies, and the people who finance the local companies with their savings, will be protected from the holding companies during this breaking-up period.

(b) Acceptance by the Industry

All the larger holding company systems fought the passage of the Act strenuously, practically two-thirds of them refusing to register with the Securities Exchange Commission because they declared the Act to be illegal. Thereupon the Securities Exchange Commission chose the Electric Bond & Share Company for the purpose of making a test case of the Act before the Supreme Court of the United States. The Commission felt that Bond & Share exemplified best the basic characteristics of the holding company operation that Senator Wheeler and other authors of the Act felt that the industry would be better off without.

While this case was being argued before the Supreme Court, registration with the Commission was at a standstill, until the Supreme Court, on January 3, 1938 upheld the government, thereby declaring the Act constitutional.

August 3, 1938, Chairman Douglas of the Securities and Exchange Commission requested by letter that all the holding companies that were affected by Section 11 of the Act, present to the Commission, not later than December 1, 1938, plans and programs, even though they were tentative, looking towards compliance with Section 11.

"On December 1, 1938 William O. Douglas, Chairman of the Securities and Exchange Commission, said that 64 top holding companies of the utility industry, including all the major systems, had given notice of their tentative plans or suggestions for voluntary compliance with the simplification and integration provisions of Section 11 of the Public Utility Holding Company Act, or had indicated the extent to which, in their view, they complied with the requirements.

"This the Chairman characterized as a response which had surpassed all expectations. He expressed the opinion that, as a result of the character of the responses, the negotiations had passed the stage of litigation, and had entered the "broad highway representing constructive action" which would be of great benefit to the industry and the country." (1)

(c) Briefs of Some of the Plans Submitted

(2) Electric Bond & Share Company, representing $3,000,000,000, one of the most widely-scattered of the holding company systems, has probably attracted more attention than any of the others, financiers in Wall Street advancing the supposition that it might become an investment trust. Officials of the company, however, state that they have always been in the utility operating business and see no reason why they should leave the field. Mr. C. E. Groesbeck, Chairman of the Board of Directors, in response to a question by a stockholder, gave an inkling of the integration line the company may be following. With an expenditure of less than 1% of the combined assets of the affiliated systems, or approximately $20,000,000, Electric Bond & Share could have three integrated systems, one in the Northwest, a second in the South and Southwest, a third in the East.

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(1) "Utilities Response Delights S. E. C." Public Utilities Fortnightly (December 22, 1938) pp. 852.

(2) Based on: "Utility Praised by the President." Boston Herald. October 15, 1938.

(1) Associated Gas & Electric Company, representing $1,037,000,000 proposes to integrate operations into two groups, a Middle Atlantic System and a Southern Group. It plans the elimination principally through merger or consolidation of 112 companies from the Associated structure, reducing the 172 companies now existing to 60, and the System will contain only three public utility holding companies when the program is finally effective.

The Associated System is the result of the acquisition and formation of over 500 corporations, of which over 328 have already been eliminated, leaving 172 at the present time.

As this holding company was one of the worst offenders in regard to pyramiding, the management has been successful in correcting this undesirable feature itself.

(2) Commonwealth & Southern Corporation of which Mr. Wendell L. Willkie is Chairman of the Board of Directors, and representing $1,194,000,000, has filed a plan, but called it "confidential", because he terms any plan for integration of southern properties of Commonwealth & Southern unfeasible until an agreement with the T. V. A. is reached. Mr. Willkie is said to have repeated his recent offer to sell any or all southern Commonwealth properties to the T. V. A. at appraisals determined by the Securities Exchange Commission. It is believed his plan consists of dividing all Commonwealth & Southern properties into two groups- northern and southern. Mr. Willkie refuses to consider the price named by Lilienthal and

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(1) Based on Letter to Security Holders, dated December 1, 1938.

(2) Based on "Big Utilities Meet Deadline." Boston Herald, December 1, 1938.

his associates of the T. V. A. as being fair for his properties in the South, and a bitter controversy is now going on, as T. V. A. is unwilling to accept an appraisal by Securities Exchange Commission.

American Gas & Electric Company, representing $488,000,000 is a registered holding company in the Electric Bond & Share system. This plan is said to be formal and not tentative. It proposes that the company limit its operations to a principal unified public utility system and two additional systems as follows:

> (1) A system to be known as the "central system" in Indiana, Ohio, West Virginia, Virginia and parts of certain adjoining states.
> (2) An additional system to be known as the "South Jersey system" located in southern New Jersey.
> (3) An additional system to be known as the "Northeast Pennsylvania system."

(1) North American Company's proposal calls for a "single integrated system" the acquisition of certain properties, and the disposal of certain others. The Commission will allow enough time to permit the various steps in the reorganization to be taken without impairing the financial integrity of the companies involved.

The United Light & Power plan calls for recapitalization, elimination of certain intermediate companies, and elimination of subsidiary operating companies by means of mergers.

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(1) Based on Boston Herald, November 9, 1939

(1) New England Power Association, a system developed over a period of thirty years in Massachusetts, New Hampshire, Vermont, Rhode Island, and some parts of Connecticut, has submitted a plan whereby, after various and sundry eliminations had been consummated, there would be a single holding company system, a single wholesale company for each state in which they operate, a single distributing company in each state in which they operate, (except Massachusetts) where they hoped gradually to reduce the number of distributing companies to the extent permitted by law and approved by the Department of Public Utilities, and some miscellaneous companies.

Mr. Frank D. Comerford, Chairman of the Board of New England Power states that they have been working on simplification of capital structure for several years, and during 1936 had eliminated two sub-holding companies, and in 1938 had eliminated all the Massachusetts Utilities Associates sub-holding companies, namely Massachusetts Lighting Companies, Central Massachusetts Light & Power Company, and Commonwealth Gas & Electric Companies, pursuant to plans of liquidation approved by the Securities Exchange Commission. They are now working on a plan of liquidation for North Boston Lighting properties, also Rhode Island Public Service Company, and later hope to liquidate Massachusetts Utilities Associates, thereby completing the simplification of their holding companies.

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(1) Based on Boston Herald, November 30, 1938

Until the newspapers published the various plans submitted by the holding companies for integration, the public has felt that the utility managements have sat idly by, accomplishing nothing during the period they were waiting for a decision by the Supreme Court of the United States as to the constitutionality of the Act.

President Roosevelt expressed himself as follows in his message to Congress March 12, 1935 transmitting the findings of the National Power Policy Committee:

"The disappearance at the end of five years of those utility holding companies which can not be justified as necessary for the functioning of the operating utility companies of the country is an objective which congressional leaders I have consulted deem essential to a realistic and farsighted treatment of the evils of public utility holding companies. For practical reasons we should offer a chance of survival to those holding companies which can prove to the Securities Exchange Commission that their existence is necessary for the achievement of public ends which private utility companies are supposed to serve."

We therefore approach 1939 with the government and the utilities in a much friendlier mood than they have enjoyed for ten years. If the government would curtail competition with private utilities, spending by the industry would be increased to an amount comparable to the $900,000,000 spent by it during 1929 and 1930. This would mean additional business for the heavy industries, and would take up some of the unemployment which is such a problem to the government.

VIII. CONCLUSION

It is the concensus of opinion among open-minded individuals connected with the electric power industry, that without the aid of the operating holding company, electric service would have been delayed a generation in reaching the thinly settled sections of the United States. The resulting losses in business are impossible to estimate.

We base our opinion upon the fact that the small independent operating company, often owned and financed by civic minded people, was unable to obtain the necessary capital to extend its facilities into areas beyond the limits of the towns. Commercial banks are limited in the amount they are able to loan to a single corporation, and city banks are not interested in loaning money to individuals with whom they are not familiar.

The operating holding company, therefore, with executives well known in the financial field, is able to secure the much needed funds for the extension of service and improvement of facilities, so necessary if dependable service is supplied.

We have cited the conditions on Cape Cod prior to the advent of operating holding company management into the field, and this is typical of conditions in many thinly settled areas throughout the United States. Being handicapped for capital the management under independent operation, found it necessary to require a minimum amount of equipment to perform a maximum task. The result was overloaded transformers,

low voltage, and ever increasing complaints from consumers. Today in this vicinity there are homes that are equipped throughout with labor-saving electric appliances, and it is only fair to assume that these appliances would not have been purchased and installed unless the consumer had reasonable confidence that under operating holding company management he would receive dependable service.

Individuals connected with the industry recognize also the high type of engineering service that the operating holding company is in a position to supply. With a skilled corps of engineers constantly on the alert for improved methods of production, transmission and distribution, the small operating company enjoys the advantages of highly skilled labor, at a minimum of cost. In this way the small company can furnish service comparable with large cities. Under independent management the small operating company was operated by a manager, and his time was divided among various jobs, management, engineering, finance, and accounting. He might have been a specialist in one of the jobs, but it was impossible for him to keep up to date along all lines.

The operating holding company maintains a staff of engineers trained in rate making. We have referred to the "promotional rate" by which the domestic customer finds it economical to use the labor-saving appliances to lighten household tasks. These rates are the result of much research and study by experts, and in the early days of the industry a rate of this type was unheard of.

Standardized methods of accounting such as are required by operating holding company management are absolutely necessary today, as the multitudinous reports and statements required by all branches of the government makes it necessary for every phase of the business to be accounted for in meticulous fashion.

The purchasing department of the operating holding company, through its ability to purchase in large quantities and discount bills, saves the small operating company in time and money. It is possible for the company to keep stock on hand at a minimum, because stock can be shipped from one property to another if it is necessary.

Thus we find that the justification of the operating holding company is found in the needs of the small operating company especially, since the services rendered along the lines of finance, engineering, accounting and purchasing are indispensable to its operation. The larger operating companies serving the metropolitan areas are in a position to maintain personnel in sufficient amount, and of equal qualifications as the holding company, therefore the operating holding company does not fulfill the same economic need, unless in the case of supplying capital.

We have shown that one of the outstanding characteristics of the industry is its ability to absorb capital to a greater extent than some other lines of business thereby attracting the attention of the financiers of the country. This concentration gradually centered around a handful of men,

mostly located within a few blocks of each other in Wall Street, giving rise to the fear among the people of the country that the public utility business had been centered in a "power trust".

It is true that these financiers did take advantage of the fact that regulation of holding company operation was lacking, and that there was a chance to make money by buying small operating companies and refinancing them through holding companies. It is to be regretted that regulation of holding companies by the state commissions did not keep pace with the rapid growth of the industry. Regulation of holding company securities was long over-due. The fact that holding companies did not consider themselves as operating companies, and therefore not subject to regulation by State Commissions led to many irregularities, the most serious of which was the writing-up of book values of properties as they were purchased, to what promoters considered their potential value. Against these values securities of the holding company were issued and sold. Even though these securities were speculative the public was eager to purchase any and all securities of electric utilities, and these promoters had no difficulty in disposing of each new issue. This flood of speculative securities helped to expand the "bubble" which burst in the stock market crash of 1929. Many people lost all their savings, many others were badly hurt, with the result that during the ensuing years politicians found a ready response from voters mostly located within a few blocks of each other in Wall Street, giving rise to the fear among the people of the country that the public utility business had been centered in a "power trust".

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Even though there were abuses, however, it has not been shown that the consumer has received any injury at the hands of operating holding company management. Politicians claim that exorbitant profits were made by the promoters through management contract fees. There were isolated cases of excessive profits, but on the whole the service received by the operating company was cheap as compared with what they would have paid if they had been able to purchase the same service independently. Statistics prove that the customer received better service, and at rates below those paid to independent companies.

Upon the basis of facts disclosed by the reports of the Federal Trade Commission, and the reports of the Committee on Interstate and Foreign Commerce, the "Public Utility Act of 1935" was passed. These investigations showed that public utility holding companies and their subsidiary companies are affected with a national public interest, and as their operations involve the use of means and instrumentalities of interstate commerce, their operations should be controlled by the Interstate Commerce Commission. As of December 1, 1938 all the major systems were registered with the Securities Exchange Commission, and had submitted plans for simplification and integration of their properties.

One of the most debated phases of the Act was Section 11 which provides a "death sentence" for many of the top

holding companies, and any that cannot be justified. It would seem that even the most reprehensible practices could be curbed by regulation, and destruction does not seem necessary. In the scheme of economic evolution the holding company represents a specialized instrument useful and usable for socially desirable purposes. As yet there has been no logic advanced that the end of the electric era has arrived, and that there is no further need for the utility operating holding company.

At this writing, January, 1939, there has been such an extensive elimination of intermediate holding companies in some of the larger systems, it may be that the industry itself, if given time, will dispense with those holding companies that are not economically justified.

The electric utility industry under private management and initiative has played an important part in the upbuilding of the United States, and it looks for an opportunity to continue its career of service and expansion.

Federal Government competition with private utilities in the Tennessee Valley, using the surplus power manufactured at Muscle Shoals as a "yard-stick", serves no economic purpose. We have shown that the government has provided so many subsidies for this development that it is impossible for the privately owned companies in the adjoining territory to meet its "yard-stick" rates, and continue to function as solvent companies.

Another means of competition by the Federal Government is through Public Works Administration loans to towns and

cities interested in operating their own electric light plant, and an outright gift of 45% of the cost is made by the Federal Government. There is every indication that the present administration at Washington very much desires Federal operation of electric power utilities. We have shown the extent to which the Government is now engaged in the power business, and the dangers that face the private companies when all the various developments now in process of construction are completed. This competition is a matter of vital concern to utility management and utility security holders, and is today perhaps the issue of greatest importance between the government and the utilities.

The function of the government in a Democracy such as ours should be regulation, not competition. There is no guarantee, given unrestrained and unregulated power in a non-competitive business, that public officials will not abuse it. There is already dissension among the ranks of the officials of the Tennessee Valley Authority.

The common-sense judgment of Thomas A. Edison in regard to government in the power business was well stated on January 5, 1929:

"There is far more danger in public monopoly than there is in private monopoly, for when the government goes into business it can pretend to sell cheap power and then cover up its losses. The government never really goes into business, for it never makes ends meet, and that is the first requisite of business. It just mixes a little business with cities interested in operating their own electric light plant, and an outright gift of 45% of the cost is made by the Federal Government. There is every indication that the present administration at Washington very much desires Federal operation of electric power utilities. We have shown the extent to which the Government is now engaged in the power business, and the dangers that face the private companies when all the various developments now in process of construction are completed. This competition is a matter of vital concern to utility management and utility security holders, and is today perhaps the issue of greatest importance between the government and the utilities.

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If Edison were living today he might have said that about T. V. A., for Dean Moreland's testimony indicates the extent to which the taxpayer's of the whole country are paying for the deficits of the T. V. A. operations in one section of the country.

We agree with the Federal Government that there should be more regulation, and that the abuses that the holding companies have been guilty of should be done away with. Nevertheless we do not agree that the Federal Government should be responsible for that part of the regulation that might better be lodged with the present State Commission.

The "Public Utility Act of 1935" states that "public utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different states; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce: (4) their

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(1) "Government and Business." Bulletin of Edison Electric Institute, 1936. Quotations from Authorities. Page 2.

practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible to effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies. (1)

In the matter of this interstate problem of the holding company it has been suggested that the compact clause of the Constitution of the United States, provides a method of solving it. Through dealing collectively or regionally the states could control and regulate the operations of the holding companies in the area. There are those, however, who argue that the capacity of the compact idea for interminable delays, and the fact that even states joined by compacts could not get at the books of a holding company operating in those states, if it also operated in other states outside the compact, would prohibit its practical use.

It is the concensus of opinion among those familiar with the problems of the industry that the preponderance of politicians as commissioners, or as assistants to commissioners, is not conducive to good results in supervision and regulation of operating utilities. Non partisan individuals, holding office regardless of political affiliations, should predominate on State Commissions.

Continued private operation of electric power utilities, under the regulation of able State Commissioners,

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(1) Section 1. Public Utility Act of 1935.

assisted by a Commission of a regional character to handle those interstate matters that are beyond the jurisdiction of the state, would seem to be the best possible method of handling this problem.

The issue of government competition is also of such vital importance that a settlement of the controversy should be reached in a cooperative manner, between the representatives of the electric industry and the government. If, as a result, there could be developed a definite government policy as regards the electric industry, so that adequate amounts of private capital, including equity capital as distinguished from refunding capital, could be raised for further expansion, something of great and lasting good would have been accomplished alike for the industry and for the nation.

History shows that every effort to over-regulate human endeavor has in the long run either failed of its purpose or curbed progress. It is generally believed that the people of the country are still in favor of growth through private enterprise, and that with a solution of the difficulties the industry will go forward rendering an essential service to the public, and affording opportunity for the beneficial employment of both labor and capital. Therefore, let us not destroy an instrument of progress born in a period of economic necessity, let us not destroy - let us build.

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